Supreme Court, U.S.
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No.

IN THE
# Supreme Court of the United States
OCTOBER TERM, 1996

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AXEL N. ELIASEN, ROBERT V. ROLLHEISER AND ALLAN L. APTER,

*Petitioners,*

v.

ITEL CORPORATION, A DELAWARE CORPORATION, ITEL RAIL CORPORATION (F/K/A ITEL RAIL CAR DIVISION), A DELAWARE CORPORATION, HOWARD L. CHABNER, JAMES CHANDLER, ROD F. DAMMEYER, JACK P. EDWARDS, DESMOND HAYES, WILLIAM J. HERNDON, GARY M. HILL, CURTIS J. HOCKADAY, ROBERT C. KIEHNLE, JAMES E. KNOX, PAUL L. LOVEDAY, CARL V. LYON, CHARLES D. MARTIN, SAMUEL ZELL, THOMAS O. KLOEHN AND QUARLES & BRADY,

*Respondents.*

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**Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit**

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## PETITION FOR A WRIT OF CERTIORARI

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## QUESTIONS PRESENTED

1. Whether a federal appeals court may *sua sponte* convert a district court's dismissal of a complaint for failure to state a claim under Rule 12(b)(6) into a motion for summary judgment where the district court denied to the non-moving parties the right to conduct discovery and further specifically refused to consider evidence outside the complaint in deciding the Rule 12(b)(6) motion.

2. Whether the appellate court's conversion of a motion to dismiss into a motion for summary judgment while acknowledging that the governing document is ambiguous was improper under Rule 56 where the appellate court failed to make all inferences and to view all fact issues in a light most favorable to the non-moving parties.

## PARTIES TO THE PROCEEDING BELOW

The parties to the proceeding in the United States Court of Appeals for the Seventh Circuit (No. 95-3458) were Axel N. Eliasen, Robert V. Rollheiser and Allan L. Apter, Plaintiffs-Appellants, and Anixter International, Inc. (f/k/a Itel Corporation), Signal Capital Holdings Corporation (successor by merger to Itel Rail Corporation), Howard L. Chabner, James Chandler, Rod F. Dammeyer, Jack P. Edwards, Desmond Hayes, William J. Herndon, Gary M. Hill, Curtis J. Hockaday, Robert D. Kiehnle, James E. Knox, Carl V. Lyon, Charles D. Martin, Samuel Zell, Thomas O. Kloehn, and Quarles & Brady, Defendants-Appellees.

Information contained in the Appellees' brief filed in the United States Court of Appeals for the Seventh Circuit discloses the following: (1) Dietche & Fields Advisors, Inc. has sole voting power for shares comprising 13.5% of the common stock of Anixter International, Inc.; and (2) the parent company of Signal Capital Holdings Corporation is SCAP Associates L.L.C.

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Axel N. Eliasen, Robert V. Rollheiser and Allan L. Apter petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

## OPINIONS BELOW

The opinion of the court of appeals is reported at 82 F.3d 731. App. A 1a-13a. The May 30, 1996 order of the court of appeals denying Petitioners' petition for rehearing is unreported. App. E 39a. The order of the district court granting defendants' motion to dismiss is reported at 883 F. Supp. 280. App. C 15a-37a. The order of the district court denying Petitioners' Rule 59(e) motion is unreported. App. D 38a.

## JURISDICTION

The judgment of the court of appeals was entered on April 29, 1996. App. B 14a. Petitioners timely filed a petition for rehearing on May 13, 1996; said petition was denied by the court of appeals on May 30, 1996. App. E 39a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

## STATUTES INVOLVED

Rule 12(b) of the Federal Rules of Civil Procedure provides in pertinent part: [1]

> How Presented. Every defense, in law or fact, to a claim for relief in any pleading, whether a claim, counterclaim, cross-claim, or third party claim, shall be asserted in the responsive pleading thereto if one is required, except that the following defenses may at the option of the pleader be made by motion: (1) lack of jurisdiction over the subject matter, (2) lack of jurisdiction over the person, (3) improper venue, (4) insufficiency of process, (5) insufficiency of service of process, (6) failure to state a claim upon which relief can be granted, (7) failure to join a party under Rule 19.
>
> * * * *

[1] Rule 12 of the Federal Rules of Civil Procedure is set out verbatim in Appendix F 40a-44a.

> If, on a motion asserting the defense numbered (6) to dismiss for failure of the pleading to state a claim upon which relief can be granted, matters outside the pleading are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56.

Rule 56(c) of the Federal Rules of Civil Procedures, Fed. R. Civ. P. 56(c), provides in pertinent part: [2]

> Motions and Proceedings Thereon. The motion [for summary judgment] shall be served at least 10 days before the time fixed for the hearing. The adverse party prior to the day of hearing may serve opposing affidavits. The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

Rule 56(f) of the Federal Rules of Civil Procedure provides:

> When Affidavits Are Unavailable. Should it appear from the affidavits of a party opposing the motion that the party cannot for reasons stated present by affidavit facts essential to justify the party's opposition, the court may refuse the application for judgment or may order a continuance to permit affidavits to be obtained or depositions to be taken or discovery to be had or may make such other order as is just.

## STATEMENT OF THE CASE

This petition arises from the *sua sponte* grant of summary judgment in favor of defendants by the Seventh Circuit Court of Appeals after the district court dismissed Petitioners' complaint under Rule 12(b)(6) for failure to state a claim upon which relief could be granted. In

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[2] Rule 56 of the Federal Rules of Civil Procedure is set out verbatim in Appendix G 45a-47a.

reaching its decision, the district court did not consider evidence outside the complaint. This was confirmed in an order of the district court (entered after the motion to dismiss was decided) in which the district court specifically articulated that it had been "required to review only the well-pleaded allegations of the complaint" in ruling on the Rule 12(b)(6) motion. (R. 88: Order dated June 1, 1995)[3] No motion for summary judgment had been filed in the district court, and neither the district court nor any party appearing before it had sought to convert the defendants' Rule 12(b)(6) motion into one for summary judgment.

Petitioners had sought to take discovery in the trial court, but their efforts were unsuccessful. The defendants moved for a stay of discovery, and the district court specifically entered an order preventing the Petitioners from conducting discovery while the Rule 12(b)(6) motion to dismiss was being considered. (R. 78: Order dated April 18, 1995.)

The April 29, 1996 opinion rendered by the court of appeals was the first notice received by the Petitioners that the defendants' motion to dismis had been converted into a motion for summary judgment. Prior to the appellate court's opinion, the Petitioners were never provided with notice that summary judgment was being considered by the appellate court. At oral argument the Petitioners were not asked to address the fairness of converting the motion to dismiss into a motion for summary judgment at such a late stage in the proceedings; nor were the parties requested to address whether the Petitioners could fairly and completely present their case to the appellate court absent the opportunity to take discovery. No opportunity had been given to Petitioners to respond to the issues that were raised for the first time in the opinion issued by the appellate court.

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[3] Parenthetical references to the record in the court below are designated herein in the form "R. ——: ————————."

Finally, and most importantly, Petitioners were prejudiced by the appellate court's *sua sponte* conversion of the motion into one for summary judgment. The Seventh Circuit's opinion expressly rejected the basis for the district court's Rule 12(b)(6) dismissal, holding that the Class B debenture's asset-distribution provision (found in the first two sentences of the debenture) is ambiguous enough to warrant the consideration of extrinsic evidence. However, having thus invalidated the basis for the Rule 12(b)(6) dismissal, the Seventh Circuit improperly granted summary judgment against Petitioners without affording them any meaningful opportunity to discover and present all of the extrinsic evidence bearing on the meaning of the language of the crucial contract document.

**A. Historical Background**

**1. *The Creation of the GB&W***

The roots of the dispute in question can be traced back some 100 years to the creation of the Green Bay & Western Railroad Co. ("GB&W"). The railroad, which after expansion ultimately came to be known as the GB&W in 1896, was chartered in 1866. The railroad company failed in 1878 and again in 1888, due to its debt service, and it became evident that another reorganization of the railroad company might not be successful unless it was reorganized without fixed debt or mortgage. Thus a novel approach was undertaken to reorganize the company without "fixed obligations" and the GB&W was formed. (R. 57: Plaintiffs' Memorandum of Law in Opposition to Motion to Dismiss at 6-7) To accomplish this reorganization, it was deemed necessary for the secured creditors to obtain the support and cooperation of the stockholders of the predecessor corporation. (The secured creditors had first claim on the tangible assets of the failed railroad, but it was the stockholders who could, under Wisconsin law,[4] bring the special exemptions, privileges and immunities previously granted

[4] Wisconsin Statute, 1889, ch. 87, § 1828.10. A copy of § 1828 of this statute is set out verbatim in Appendix H 48a-50a.

to the predecessor railroad into the reorganized company which the company would need in order to operate the railroad.) The parties agreed, pursuant to a reorganization agreement, to work toward a common goal—make the railroad successful while protecting the respective economic interests of the creditors and shareholders. The reorganization was accomplished by assuring that the first mortgage bondholders and the common stockholders of the predecessor company would retain their same relative economic positions in the new company, but voting control was shifted from the junior securities of the old company to the secured creditors of the old company. (R. 57: Plaintiffs' Memorandum of Law in Opposition to Motion to Dismiss at 7)

The secured creditors of the old company received a class of security termed "capital stock"—the only "voting" security—in the new company. *Id.* This capital stock carries preference (over the Class B debentures) with respect to distributions (both out of annual income and, in dissolution), but the amounts of the distributions are limited. The new capital stock, therefore, corresponded, in priority and in book value, to the debt obligation of the predecessor company that it was replacing; but without having fixed-payment requirements. *Id.*

The second-mortgage bond holders and preferred and common stockholders of the predecessor corporation surrendered their securities and also paid $570,000 in cash, receiving in exchange equity securities, called "Class A debentures" and "Class B debentures" in the new company.[5] *Id.*

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[5] This transaction is described in detail in *GB&W v. Comm'r*, 8 T.C. 372, 373-374, *aff'd*, 147 F.2d 585 (7th Cir. 1947). Petitioners, in terming the Class A and Class B debentures "equity securities," rely on the court's reasoning in *GB&W v. Comm'r* ("the debentures represent proprietary interests in the corporation") and *Biltchik v. GB&W*, 250 Wis. 177, 26 N.W.2d 633 (1947) (the holders of Class B debentures are "instead of the stockholders, the owners of the equity of the corporation"). Those courts relied on the criteria originally provided by this Court in *Warren v. King*, 108 U.S. 389 (1883). They analyzed the Class B debenture based upon the

The rights of each of the three classes of equity security holders and the manner of distribution and payment to their holders were prescribed in 1895 in a Reorganization Agreement. *Id.* This agreement was negotiated between a committee representing the holders of first (and consolidated) mortgage bonds and a committee representing the holders of second mortgage income bonds and preferred and common stock of the predecessor company. The Reorganization Agreement prescribed the capital structure for the new corporation and the manner in which the net assets of the GB&W were to be divided upon its sale or reorganization. The Reorganization Agreement provides:

> . . . the proceeds of such sale or reorganization shall, after payment of all liens and charges upon said property be first distributed to and among the holders of Class A debentures and the stock holders *pro rata* and any surplus remaining after payment of the face value of said Class A debentures and the par of said stock, shall be distributed *pro rata* to and among the holders of the Class B debentures.

(R. 55: Second Amended Complaint, ¶ 40)

The 1896 Articles of Incorporation of the GB&W provide that upon sale or reorganization, any net proceeds which remain after payment of liens and charges, $600,000 to the holders of Class A debentures, and $2,500,000 to the stockholders, are "to be distributed *pro rata* to and among the holders of the Class D debentures." *Id.* at ¶ 40.

In a similar fashion, the Class A debenture specifies that upon sale or reorganization, "any surplus remaining after payment of the face value of the entire series of Class A debentures [$600,000] and the entire par value of the capital stock [$2,500,000] shall be distributed *pro rata* to and among the holders of a series of $7,000,000

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**language of the debenture as written, without regard to the market value of the GB&W's securities at the time the analyses took place. The court of appeals in this case ignored the plain meaning of the debenture's language and, instead, based its opinion on the court's presumed market value of the GB&W.**

Class B debentures issued or to be issued" by the GB&W. *Id.* at ¶ 43(a).

Finally, the Class B debenture is consistent with the other reorganization documents. It specifies in pertinent part:

> The Green Bay & Western Railroad Company hereby certifies that this is one of a series of seven thousand of its Class B Debentures, in the sum of—ONE THOUSAND DOLLARS—each, aggregating in all the sum of Seven Million Dollars, which sum of One Thousand Dollars will be payable to the bearer hereof as follows: viz., only in the event of a sale or reorganization of the Railroad and property of said Company, and then only out of any net proceeds of such sale or reorganization which remain after payment of any liens and charges upon such Railroad or property, and after payment of Six Hundred Thousand Dollars to the holders of a series of Debentures known as Class A, issued or to be issued, by said Company, and the sum of Two Million Five Hundred Thousand Dollars to and among the stockholders of said Company. *Any* such net proceeds remaining after such payment shall be distributed pro rata to and among the holders of this series of Class B Debentures. (Emphasis added.)

*Id.* at ¶ 43(a).

### 2. *Itel's Purchase and Sale of the GB&W*

Pursuant to an amended offer dated December 8, 1977, Intel acquired voting control of the GB&W by acquiring 99.9% of the capital stock, but Itel obtained only approximately 78% of the Class B debentures. (R. 55: Second Amended Complaint, ¶¶ 45-48) Thus, Itel's attempt to fully acquire the GB&W was unsuccessful because 22% of the Class B debentures remained in the hands of others. *Id.* Itel's acquisition could only become fully successful if the equity right of the non-Itel Class B debenture holders to their proper portion of "any" net proceeds remaining was somehow nullified. *Id.* Most of the schemes complained of in the Second Amended Complaint were quickly hatched by Itel for the purpose of stealing a large

portion of the equity of the GB&W from the non-Itel Class B debenture holders, including the diversion of revenues to Itel from the GB&W and leaving the GB&W with unwarranted expenses. (R. 55: Second Amended Complaint, ¶¶ 5, 53-60(o))[6]

In 1991, Itel initiated steps to sell the operating assets of the railroad. A sale was consummated in 1993 when the operating assets of the GB&W, along with the Fox River Valley Railroad (another continguous railroad controlled by Itel), were jointly sold to the Wisconsin Central for a total price of $64.2 million. (R. 55: Second Amended Complaint, ¶¶ 58, 60(q)) Although Itel had reputedly valued, internally, the GB&W's operating assets from $19.2 million to as high as $52.8 million and the GB&W's non-operating assets were stated to have a value of approximately $20 million,[7] Itel allocated only $8.4 million of the combined purchase price to the GB&W's operating assets and advised the Class B debenture holders that they were entitled to receive no more than $1,000 per debenture. (R. 55: Second Amended Complaint, ¶¶ 60(p), 60(r))

The Petitioners filed this suit seeking, in part, to have the GB&W's operating assets assessed at a proper valua-

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[6] The GB&W, under the control of the defendants, made no dividend payments to any of its security holders from 1977 through 1991. (R. 55: Second Amended Complaint, ¶ 8(a)). Much of GB&W's reputed net income of $14 million was siphoned off to Itel for its use, through unsecured loans to Itel of as much as $7.2 million during that period of time. (R. 55: Second Amended Complaint, ¶ 60(b)). Thus, Itel used the income of the GB&W to enrich itself instead of either applying the income to betterments and improvements (as the court in *Biltchik* had prescribed) or making dividend payments to its security holders. (R. 55: Second Amended Complaint, ¶ 63).

[7] A state trial court in Wisconsin determined the value of the GB&W's cash, investments, receivables and real estate which would remain after the sale of the operating assets to be $20 million, *Leuw v. GB&W* (Wis. Cir. Ct. Feb. 1, 1993), No. 89-CV-53, slip op. at 50. (R. 51: Appendix to Memorandum in Support of Defendants' Motion to Dismiss Plaintiffs' First Amended Complaint.)

tion and to have the minority Class B debenture holders declared to be entitled to their portion of any proceeds remaining after the payment of: "all lien and charges," $1,000 per outstanding Class A debenture and $100 per outstanding share of common stock, as specified in the second sentence of the asset distribution provision of the Class B debenture.

**B. The Ruling by the District Court**

Petitioners filed suit against the defendants alleging that defendants had violated the federal Racketeer Influenced and Corrupt Organizations Act ("RICO") statutes, had violated § 10(b) of the Securities Exchange Act (15 U.S.C. § 78j), had breached their fiduciary duties, had tortiously interfered with contract rights, and had converted Petitioners' property rights. Petitioners also sought an accounting and a declaratory judgment relating to the rights of the Class B debenture holders. (R. 55: Second Amended Complaint) The district court had jurisdiction over the subject matter of this action pursuant to RICO, 18 U.S.C. § 1961 *et seq.*, 18 U.S.C. § 1964(a) and (c)), 18 U.S.C. § 1965 and 28 U.S.C. § 1331.

Petitioners alleged that the defendants engaged in several elaborate schemes to defraud the Petitioners, and the class they proposed to represent, out of monies due them as minority owners of Class B debentures.[8] The district court summarized some of the specific acts of misconduct upon which Petitioners based their claim as follows:

> (a) Itel and Itel Rail with the advice and consent of the individual defendants vitiated the managerial responsibility of the GB&W board of directors by entering into commercially unreasonable leases with GB&W, causing an increase in costs to GB&W and a concomitant reduction in plaintiffs' equity interest. According to the complaint, from 1978 through 1991 GB&W suffered damages in excess of $17,000,000

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[8] Petitioners rely, in part, on the precept that those who own a majority of a security (Itel owns 78% of the Class B debentures) have a duty of fairness to the minority as promulgated by this Court in *Jackson v. Ludeling*, 21 Wall. 616, 622 (1874).

as a result of such leasing transactions with Itel and Itel Rail, injuring plaintiff's alleged equity interests;

(b) From 1947 through 1977, following the *Biltchik* decision,[9] GB&W paid out annual income to capital stock and Class A debenture holders every year, and to Class B debenture holders in "most" years. From 1978 through 1991, however, Itel and Itel Rail, with the advice and consent of the individual defendants and Kloehn and Quarles, have not paid out annual income to Class B debenture holders, and then "siphoned off" $7.2 million in GB&W profits by upstreaming cash to themselves through unsecured loans, without approval of the GB&W board;

(c) From November 1978 through May 1979, GB&W made at least six unsecured loans to Itel totaling $5.2 million, despite Itel's poor financial condition and its eventual filing for bankruptcy;

(d) From 1987 through 1991 GB&W made a series of unsecured loans to Itel and Itel Rail totaling at one point $7.7 million, with $7.2 million outstanding at the end of 1991. Plaintiffs allege that this shows that GB&W had excess cash which was not applied to corporate betterment, as required by *Biltchick*, and which jeopardized plaintiffs' "equity" interests;

(e) From March 1982 through November 1994 (the date the second amended complaint was filed in the instant case) defendants have falsified GB&W's books and records, financial statements and government filings to treat the Class B debentures as debt instruments which give their holders no proprietary interest in GB&W and its equity, and to treat the capital stock as the only equity security. By so doing, according to plaintiffs, defendants have transferred all of GB&W's equity above $1,000 per share of capital stock from the Class B debenture holders to Itel. * * *. Annual financial reports sent

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[9] This reference should have been to *GB&W v. Comm'r*, 147 F.2d 585 (7th Cir. 1947) rather than to *Biltchik*.

> to stockholders via U. S. mail from 1982 through 1993 indicate the Class B debentures as debt, and "imply" that GB&W is a wholly owned subsidiary of Itel Rail. These books and records, financial reports, and government filings were allegedly used by defendants to deceive creditors by making it appear that Itel and Itel Rail were and are the owners of all GB&W equity, and were presented to banks to acquire loans.

App. C 28a-30a. As the district court pointed out, its list was representative and not intended to be exhaustive.

Petitioners' suit seeks to recover their proper portion of those net proceeds from the sale of the operating assets of the railroad (and of the other properties of the GB&W which remain after the sale of the operating assets) after payment of all liens and charges against the GB&W, payment of the face value of the outstanding Class A debentures, and payment of the par value of the outstanding shares of capital stock. It is Petitioners' position that the Class B debenture specifies that the Class A debenture holders and holders of common stock are entitled to no more than the face and par amounts, respectively (which would total $3,100,000 if all the originally issued Class A debentures and shares of common stock were still outstanding), upon the sale of the GB&W and, that the Class B debenture holders are entitled to their proper portion of any net proceeds that remain. The only equity security whose contract does not contain a limitation in distribution upon sale is the Class B debenture.

In spite of the fact that Petitioners' claim was supported by (and indeed, based on) the language of the Class B debenture, the district court concluded that the Class B debenture "is clear and unambiguous and under its plain wording, plaintiffs are not entitled to anything more than $1,000 per debenture upon the sale of GB&W to Wisconsin Central." App. C 36a. The district court further erroneously concluded that "[b]ecause all of the plaintiffs' claims are predicated upon their incorrect assertion that they, as Class B debenture holders, are the real

holders of the equity of GB&W, the complaint as a whole fails to state a claim upon which relief can be granted and must be dismissed." App. C 36a.

**C. The Ruling by the Court of Appeals**

The Seventh Circuit did not agree with the district court's holding that the complaint should have been dismissed for failure to state a claim. The court of appeals determined that the complaint did state a cause of action because the language of the Class B debenture is ambiguous and necessitates the consideration of extrinsic evidence. App. A. 10a. However, rather than allow discovery to proceed at the trial level, the court of appeals wrongly assumed that there were no facts in existence other than the allegations in and exhibits to the pleadings; it inappropriately weighed the evidence in this incomplete form, resolved all inferences against the Petitioners herein (the non-movants in the court below), and without prior notice converted the motion to dismiss into a motion for summary judgment and granted same.

## REASONS FOR GRANTING THE PETITION

The case presents questions of exceptional legal and practical importance. The Seventh Circuit's decision is unprecedented, manifestly incorrect and inconsistent with this Court's prior decisions. The decision of the court of appeals improperly expands a court's right to grant summary judgment, *sua sponte*, such that the protections provided to a litigant under Rule 56 and Rule 12(b) are, for all intents and purposes, made meaningless. The court of appeals' ruling will cause inconsistent application of Rule 56; the ruling overturns long-standing precedents which allow for adequate discovery before the granting of summary judgment. Departing from the standard that is articulated in *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986), the court below converted a motion to dismiss into a motion for summary judgment *sua sponte* even though the Petitioners had received no notice that such a conversion was being considered and were given no

opportunity to conduct discovery and present evidence to support their claims.

The court of appeals specifically stated that the language of the Class B debentures could be interpreted in a way which would support the Petitioners' position that the Class B debenture holders were entitled to "any such net proceeds remaining . . ." following a sale of the railroad and property. App. A at 10a. However, rather than allow the Petitioners the opportunity to conduct discovery in order to present all of the facts supporting their interpretation of the language of the Class B debenture (which also was the interpretation placed on the Class B debenture at various times by the GB&W, by Itel itself, by the U.S. Tax Court, by the Seventh Circuit Court of Appeals and by the Wisconsin Supreme Court), the court of appeals took it upon itself to presume certain "facts" even though the record contained no such "facts," and to resolve concededly ambiguous language in the Class B debenture, on the basis of an incompletely developed factual record. The court of appeals apparently drew every inference *against* the Petitioners in order to grant summary judgment in this matter.

Left undisturbed, the appeals court's misapplication of long-standing principles concerning the granting of summary judgment will, *inter alia,* allow federal courts to deprive litigants of their right to a trial by jury by converting Rule 12(b)(6) motions into motions for summary judgment without notice and without allowing for discovery. If the courts of appeals are allowed to treat pleadings and accompanying exhibits as the equivalent of a fully-developed record, and to enter summary judgment based only on the facts set forth therein, there will be no guarantee to a litigant that a Rule 12(b)(6) motion is not a Rule 56 motion in disguise, the true identity of which will not be revealed until the premature end of the case.

The court of appeals acted beyond its authority in denying Petitioners their right to conduct discovery in

this matter, in resolving the ambiguity that it specifically stated exists in the Class B debenture, and in granting summary judgment *sua sponte*. Plaintiffs who are facing summary judgment should be afforded wide, rather than no, discovery, especially where, as in this case, the main source of evidence is in defendants' files (totalling 100-200 file drawers) (R. 77: Defendants' Motion to Stay Discovery), is in the prospective testimony of witnesses and/or is in the files of the GB&W which is under the control of defendant Itel. The appellate court's granting of summary judgment *sua sponte* without the Petitioners having had an opportunity to conduct discovery has so far departed from the accepted and usual course of judicial proceedings as to call for the exercise of this Court's power of supervision.

Petitioners contend, further, that summary judgment should not have been granted because even on the underdeveloped record at the court of appeals' disposal, Petitioners demonstrated the existence of genuine issues of material fact.

## I. THE *SUA SPONTE* GRANT OF SUMMARY JUDGMENT BY THE SEVENTH CIRCUIT IS INCONSISTENT WITH THE STANDARDS ESTABLISHED BY THIS COURT IN *CELOTEX CORP. v. CATRETT* AND *ANDERSON v. LIBERTY LOBBY, INC.*

This Court has made it clear that federal district courts possess the power to enter summary judgment *sua sponte* so long as the losing party is on notice that it has to come forward with all of its evidence *and* has been given adequate time for discovery, and therefore, Petitioners are not seeking a review by this Court of a court's general power to grant such a motion. *Celotex Corp. v. Catrett*, 477 U.S. 317, 322, 326 (1986). Rather, Petitioners seek review of this decision of the court of appeals which offends due process and is inconsistent with well-recognized principles governing the granting of summary judgment. The Petitioners in this case had not been placed on notice that they had to come forward with all evidence in exist-

ence supporting their claims until the decision of the court of appeals issued. In addition, Petitioners were not given any time (let alone adequate time) for discovery. Failure to allow for discovery mandates that summary judgment not be entered. As this Court stated,

> In our view, the plain language of Rule 56(c) mandates the entry of summary judgment, *after adequate time for discovery* and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial. (Emphasis added.)

*Id.* at 322. A motion for summary judgment should be denied (or, at a minimum, deferred) where the non-moving party has not had an opportunity to conduct discovery. As this Court specifically noted in *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986), the requirement that a party set forth specific facts showing that there is a genuine issue for trial "is qualified by Rule 56(f)'s provision that summary judgment be refused where the non-moving party has not had the opportunity to discover information that is essential to his opposition." *Id.* at 250, n.5. Thus, even if the defendants in the district court had filed a motion for summary judgment instead of the Rule 12(b)(6) motion they did file, under *Celotex* and *Anderson* the district court would have been required to allow Petitioners adequate time to conduct discovery before deciding the motion.

The court of appeals in the instant case has denied unfairly Petitioners' due process entitlement to notice that the defendants' motion to dismiss would be converted into a motion for summary judgment, and to a full and fair opportunity to present their case. The court of appeals erroneously concluded that *sua sponte* summary judgment was appropriate by wrongly imputing to Petitioners receipt of the required notice that they had to come forward with all of their evidence. The Seventh Circuit compounded this error in its assumption that Petitioners "laid out their extrinsic evidence—the evidence

they think creates a triable issue—in full in their briefs in this court." App. A 12a. Under the rationale of the Seventh Circuit here, virtually every motion to dismiss under Rule 12(b)(6) could be silently converted on appeal into a motion for summary judgment since the opposing party will have "laid out" evidence (in the form of pleadings and exhibits to the pleadings) to support its argument that the complaint states a cause of action. However, the "Federal Rules of Civil Procedure do not require a claimant to set out in detail the facts upon which he bases his claim." *Conley v. Gibson,* 355 U.S. 41, 47 (1957). Thus, a litigant need only set forth a set of facts which support his claim in order to defeat a Rule 12(b)(6) motion to dismiss and need not set out in detail all of the evidence in existence. In responding to the Rule 12(b)(6) motion that was before the district court, Petitioners cited to the facts set out in the complaint and accompanying exihibits. These facts were not all of the discoverable evidence, but rather evidence sufficient to state causes of action.

In the district court, the defendants moved to stay discovery while their Rule 12(b)(6) motion to dismiss was pending on the grounds that Petitioners' discovery request would require the production of 100 to 200 file drawers of documents. (R. 77: Defendants' Motion to Stay Discovery) Despite Petitioners' objection to the stay (R. 76: Plaintiffs' Response in Opposition to Motion to Stay Discovery), the district court stayed discovery while it considered the Rule 12(b)(6) motion. (R. 78: Order dated April 18, 1995) Thus, Petitioners were denied the opportunity to review an extensive body of discoverable evidence that spanned over a period of 100 years and were prevented from laying out all of the relevant evidence. For this reason alone, it was both improper and incorrect for the court of appeals to presume and conclude that there was no other evidence in existence that could support the Petitioners' claims.

The district court, relying solely on the language of one sentence in the Class B debenture, taken out of context,

concluded that the distribution provision of the Class B debenture (contained in the first two sentences of the debenture) was unambiguous and that the Class B debenture holders were entitled to no more than $1,000 per debenture. However, it is clear from the common meaning of the words on the face of the Class B debenture ("[*a*]*ny* such net proceeds remaining . . . shall be distributed *pro rata* to and among the holders of . . . Class B debentures") (emphasis added), that Petitioners' claim to their proper portion of the proceeds remaining from the sale of the GB&W, after payment to the Class A debenture holders and the common stockholders, could not be rejected as a matter of law. Thus, the district court erred in concluding that the complaint failed to state a claim. The court of appeals correctly recognized the district court's error. App. A 10a. The court of appeals found that

> Since the debenture makes no explicit provision for the allocation of the net proceeds of sale above $10.1 million, and since the last sentence that we quoted from the debenture certificate, ["Any such net proceeds remaining after such payments shall be distributed *pro rata* to and among the holders of this series of Class B Debentures."] the sentence on which the plaintiffs pitch their case, provides at least some support for [Plaintiffs' interpretation], there is enough ambiguity to permit the consideration of extrinsic evidence, that is, evidence outside the text of the Class B debenture itself.

App. A 10a.

Once the court of appeals determined that the Class B debenture was ambiguous, it was not in a position to decide which party's interpretation of the ambiguous language was correct. The court of appeals should have remanded the case to the district court for further consideration by the district court *after* the Petitioners were given time to conduct discovery. As this Court stated:

> Summary judgment is available only when, "after adequate time for discovery and upon motion," the

> party seeking summary judgment has satisfied its "responsibility of informing the district court of the basis for its motion, and identifying those portions of 'the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any,' which it believes demonstrate the absence of a genuine issue of material fact." *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986).

*Atchison, T. & S.F.R. v. Buell*, 480 U.S. 557, 568 n.15 (1987). Because of the perceived ambiguity in the Class B debenture, there was a genuine issue of material fact present. It was, therefore, improper for the court of appeals to grant summary judgment on a record "insufficiently developed at this preliminary stage" and "to express an opinion on [Petitioners'] ultimate chance of recovery" on the Class B debenture. *Id.* at 564.

The court of appeals erred in depriving the Petitioners an opportunity to dispute the facts material to the ambiguity found by the appellate court in the language of the Class B debenture. In a factually analogous situation where a court of appeals entered summary judgment on an issue not considered by the district court, this Court stated:

> Summary judgment may be given, under Rule 56, only if there is no dispute as to any material fact. There was no occasion in the trial court for Mrs. Fountain to dispute the facts material to a claim that a personal obligation existed, since the only claim considered by that court on her motion for summary judgment was the claim that there was a resulting trust. *When the Court of Appeals concluded that the trial court should have considered a claim for personal judgment it was error for it to deprive Mrs. Fountain of an opportunity to dispute the facts material to that claim by ordering summary judgment against her.* (Emphasis added.)

*Fountain v. Filson*, 336 U.S. 681, 683 (1948). In a similar fashion, by granting summary judgment here where no such motion had been presented in the district court,

the court of appeals in the case at bar deprived the Petitioners of the opportunity to respond to the ambiguity which the appellate court believes exists. *Id.* at 683.

The Seventh Circuit exceeded its authority in converting the Rule 12(b)(6) motion into a motion for summary judgment, it failed to comply with Rule 12(b) and Rule 56 of the Federal Rules of Civil Procedure, and its decision is in conflict with decisions of this Court. Review should be granted by this Court to resolve this conflict "with relevant decisions of this Court." Rule 10(c), Rules of the Supreme Court of the United States.

## II. THE *SUA SPONTE* GRANT OF SUMMARY JUDGMENT BY THE SEVENTH CIRCUIT IS INCONSISTENT WITH NUMEROUS DECISIONS OF THE COURTS OF APPEALS.

The decision below conflicts not only with *Celotex* and *Anderson*, but also with numerous decisions of other courts of appeals. The issuance of a *sua sponte* summary judgment requires both notice that such is being considered by the court *and* the opportunity to conduct discovery. Review is necessary here to resolve the circuit split created by the Seventh Circuit's less stringent standard for granting *sua sponte* summary judgment. Rule 10(a), Rules of the Supreme Court of the United States.

The courts of appeals for the Sixth and Eleventh Circuits, the District of Columbia, and the Federal Circuit have consistently disallowed *sua sponte* summary judgment when discovery has not been allowed. In *White's Landing Fisheries, Inc. v. Buchholzer*, 29 F.3d 229 (6th Cir. 1994), the court held that even when plaintiffs had to "jump a high hurdle" to succeed on their claim, discovery must be allowed before summary judgment is granted. *Id.* at 231 (citing *Celotex* and *Anderson*). The court further held that the benefits of summary judgment are "quickly undermined" if summary judgment is misused in a manner that "offends concepts of fundamental fairness." *Id.* Granting summary judgment "absent *any* opportunity for discovery" is plainly such a misuse. *Id.*

(emphasis in original). Likewise, in *WSB-TV v. Lee*, 842 F.2d 1266 (11th Cir. 1988), the Eleventh Circuit held that when a party has been afforded "no opportunity for discovery," summary judgment is impermissible because summary judgment may be decided only upon an "adequate record." *Id.* at 1269 (citing *Celotex* and *Anderson*); *see also Dean v. Barber*, 951 F.2d 1210 (11th Cir. 1992) ("A party opposing summary judgment should be given the opportunity to discover information relevant to the summary judgment motion"); *Snook v. Trust Co. of Georgia Bank of Savannah, N.A.*, 859 F.2d 865, 870 (11th Cir. 1988) ("This court has often noted that summary judgment should not be granted until the party opposing the motion has had an adequate opportunity for discovery").

In similar fashion, the Court in *Dunkin' Donuts of Am., Inc. v. Metallurgical Exoproducts Corp.*, 840 F.2d 917 (Fed. Cir. 1988), rejected an attempt to obtain summary judgment after the filing of a Rule 12(b)(6) motion where plaintiffs had not had "any opportunity to gather evidence through discovery." *See also id.* at 919. ("The Supreme Court has made clear that summary judgment is inappropriate unless a tribunal permits the parties adequate time for discovery") (citing *Celotex*); accord, *Burnside-Ott Aviation Training Ctr., Inc. v. United States*, 985 F.2d 1574, 1582 (Fed. Cir. 1993) (where defendant's intention when contract was awarded was "relevant, the [court] erred in granting summary judgment on this issue without allowing adequate discovery").

And in *First Chicago Int'l v. United Exch. Co., Ltd.*, 836 F.2d 1375 (D.C. Cir. 1988), where after finding that no party had waived discovery, the court held that it was "premature" for a lower court to convert a 12(b)(6) motion to dismiss into a motion for summary judgment when "virtually no discovery on the merits had occurred." *Id.* at 1379-80. The court emphatically stated that it is "settled" that all parties subject to such a conversion receive the opportunity "to pursue reasonable discovery." *Id.* at 1380 (citing *Celotex* and *Anderson*).

By permitting summary judgment in the absence of any discovery, the *sua sponte* summary judgment granted in the case at bar, contravenes decisions of numerous courts of appeals which have followed the strictures of *Celotex* and *Anderson*. The basis for the Seventh Circuit's presumption that in response to the Rule 12(b)(6) motion to dismiss, Petitioners "laid out their extrinsic evidence—the evidence they think creates a triable issue—in full in their briefs" is clearly at odds with these decisions of other courts of appeals. In fact, in its haste to wield its *sua sponte* summary judgment sword, the appellate court never addressed the discovery requirement. Plenary review is warranted to resolve this disarray in the circuit courts of appeals.

In addition to the above courts, which have specifically rejected *sua sponte* summary judgment where no discovery has occurred, the First Circuit Court of Appeals has also addressed the issue of notice. It has held that courts should strictly adhere to the notice requirement of *sua sponte* summary judgment. In *In re San Juan Dupont Plaza Hotel Fire Litig.*, 45 F.3d 564 (1st Cir. 1995), motions requesting and opposing leave to file for summary judgment were made. The court held that summary judgment was not appropriate even if the motions outline the "substance of the parties' respective positions on the merits," *Id.* at 567, because the notice requirement can only be satisfied if the court can be "completely certain" that the merits of the issue have been "*fully* presented." (emphasis in original). In the case at bar, Petitioners' position concerning the interpretation of the language of the Class B debenture could not have been "*fully* presented" to the court, for Petitioners were denied discovery of "100 to 200 file drawers of documents" as well as deposition testimony of witnesses pending consideration of the Rule 12(b)(6) motion to dismiss.

The court of appeals' overly hasty invocation of *sua sponte* summary judgment is unreasonable and constitutes reversible error. *See, e.g., Stella v. Town of Tewksbury*, 4 F.3d 53, 56 (1st Cir. 1993) ("*Sua sponte* judgment is a

remedy which, although available, must be handled with care. In this tricky area of the law, an undue emphasis on speed is a surefire way to court reversal"); *Jardines Bacata, Ltd. v. Diaz-Marquez*, 878 F.2d 1555, 1560-61 (1st Cir. 1989) (summary judgment *sua sponte* power should be "exercised sparingly. Courts that yearn for the blossom when only the bud is ready act at their peril; proceeding with unnecessary haste frequently results in more leisurely repentance.").

In the instant case, the court of appeals eviscerated the important procedural safeguard of notice prior to entry of summary judgment by concluding that notice is served merely when a party, in response to a Rule 12(b)(6) motion, has "laid out their extrinsic evidence—the evidence they think creates a triable issue—in full in their briefs in this court." Such a conclusion flies in the face of the strict standard of *Celotex* and *Anderson*. It is unfair of the Seventh Circuit in this matter to suggest that Petitioners' reference to facts set forth in their complaint in a response to a motion to dismiss for failure to state a cause of action, may be recast by the appellate court as a response to a motion for summary judgment. The court of appeals' ruling constitutes a cavalier disregard for the notice requirement. *See, e.g., Lugo v. Keane*, 15 F.3d 29, 30 (2d Cir. 1994) ("[N]o principle is more fundamental to our system of judicial administration than a person is entitled to notice before adverse judicial action is taken against him.") (citing, *inter alia*, *Volkswagenwerk Aktiengesellschaft v. Schlunk*, 486 U.S. 694, 707 (1988)); 10A C. Wright, A. Miller, & M. Kane, *Federal Practice and Procedure*, § 2720 at 34 (1983) ("Great care must be exercised to assure that the [unsuccessful party] has had an adequate opportunity to show that there is a genuine issue and that his opponent is not entitled to judgment as a matter of law.")

Petitioners request that this Court exercise its supervisory power to preserve both the notice requirement and the requirement that litigants be allowed to develop a

complete record through discovery before summary judgment motions are entertained.

## III. THE RULINGS OF THE LOWER COURTS—THAT NO ISSUE REQUIRING TRIAL WAS SHOWN TO EXIST—CONFLICT WITH DECISIONS OF THIS COURT AND OF OTHER COURTS OF APPEALS.

Assuming, *arguendo*, that the court of appeals was within its authority to consider the matter as having come before it pursuant to a motion for summary judgment and, further that plaintiffs had no right to conduct discovery so as to be able to respond to the issues to be decided by the appellate court, the limited record that did exist demonstrated the existence of genuine issues of fact with respect to the comparative rights of the various classes of equity security holders of the GB&W, particularly the rights in dissolution. The full context of the first two sentences of the Class B debenture (which are quoted *supra* at p. 7) are relevant to the rights of the Class B debenture holders in this matter.[10]

The second sentence specifies that *any* net proceeds remaining after the payments listed in the first sentence are made, shall be distributed to the Class B debenture holders *pro rata*. However, the court of appeals concluded that in the language of the first two sentences of the Class B debenture "there is enough ambiguity to permit the consideration of extrinsic evidence, that is, evidence outside the text of the Class B debenture itself." App. A 10a. Under these circumstances, the appellate court was constrained to remand the matter to the district court to resolve the comparative rights of the various classes of equity security holders after a full hearing. The finding of "ambiguity" also dictated that the court of appeals reverse the district court with respect to the district court's conclusion that Petitioners failed to state a cause of action.

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[10] The contractual right of the holders of the GB&W capital stock in the event of a sale or reorganization of the railroad is specified in the Class A debenture and in the Class B debenture.

The court of appeals was not the place to resolve the ambiguity of the Class B debenture in the first instance. *Consarc Corp. v. Marine Midland Bank, N.A.*, 996 F.2d 568, 574 (2nd Cir. 1993). There should have been no weighing of evidence or resolving of possible inferences from the limited facts in the complaint at this stage of the proceedings. However, if the court wished to indulge in such activity, it was required to resolve all factual disputes in favor of Petitioners and draw all inferences from the facts then available in Petitioners' favor. *United States v. Diebold, Inc.*, 369 U.S. 654, 655 (1962). This the court of appeals failed to do, apparently in order to present a novel economic theory that was neither argued nor considered by the parties.

Had the appellate court considered the evidence before it in a light most favorable to Petitioners and made all inferences in favor of Petitioners, it could not have entered summary judgment in favor of defendants. Documents identified in the complaint other than the Class B debenture (e.g., the precedential Reorganization Agreement) supported Petitioners' claim that Class B debenture holders were entitled to their proper portion of the proceeds that remained from the sale of the GB&W after certain payments were made. The reorganization of the predecessor railroad company into the GB&W railroad company brought forth four documents which were all part of the single transaction—the reorganization of the GB&W: the Reorganization Agreement; The Articles of Incorporation; the Class A debenture; and the Class B debenture. Read together, it is clear that it is the holders of Class B debentures who are to receive "any" net proceeds remaining from the sale of the GB&W after the specified payments are made.[11]

Thus, the evidence from the reorganization of the GB&W alone provided ample evidence to support Petitioners' position. This evidence, without more, is clearly

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[11] Wisconsin Statute, 1889, ch. 87, § 1879 prescribed that any mode of dissolution provided for in the corporate articles must be followed.

sufficient to allow Petitioners to state a claim against the defendants and, it certainly supports Petitioners' interpretation of the Class B debenture language—language that the court of appeals found to be ambiguous by ignoring the common meaning of the word "any"—"no matter how great or small." The sufficiency of this evidence with respect to a Rule 12(b)(6) motion, or for that matter a Rule 56 motion, would be overwhelming had the court of appeals resolved all issues in favor of the Petitioners and made all inferences flowing therefrom in Petitioners' favor. However, the court of appeals resolved all fact questions against the Petitioners and, made inferences which supported the defendants, the movants. For instance, on several occasions the GB&W and/or some of the defendants supported the Petitioners' interpretation of the Class B debenture by making statements to the effect that under the reorganization documents the Class B debenture holders were entitled to all sums in excess of $3.1 million which remained upon the sale or reorganization of the railroad after payment of all liens and charges.[12] The court of appeals dismissed this evidence because it incorrectly concluded that the Petitioners presented no evidence regarding the market value of the railroad's securities at any of the times when the defendants' statements on which Petitioners rely were made.[13]

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[12] For instance, Defendant Itel specifically stated in its Amended Offer in 1977 its understanding that, in the event of sale or reorganization, holders of stock "would only be entitled to receive $100 per Share and holders of Class A Debentures would be entitled to receive $1,000 per Debenture. Any net proceeds remaining . . . would be required to be distributed *pro rata* to the holders of Class B Debentures." (R. 55: Second Amended Complaint, Exhibit D.)

[13] However, the court of appeals ignored the argument made by the GB&W to the Wisconsin Supreme Court in *Biltchik*. In response to the plaintiffs' argument that the Class B debenture holders were limited to $1,000 upon sale or reorganization, the GB&W argued in its brief that the book value of the company was $13,435,660.60 and that,

> Upon a sale or reorganization, the holders of the stock and Class A Debentures are limited to a return of their original

App. A 11a. However, the defendants, on the other hand, certainly offered no evidence of the market value of the GB&W's securities at the time the defendants' statements in question were made nor did the defendants offer evidence or argument that the railroad's securities' market value was relevant to the makers of the statements at the time the statements were made.[14] The argument of the GB&W before the Wisconsin Supreme court makes the assumptions of the court of appeals in the case at bar inoperative. Its assumption that statements such as Itel's Amended Offer, or GB&W's argument in *Biltchik*, were not admissions against the interests of the capital stockholders because the GB&W's securities were trading for less then $10.1 million at the time the statements were made is unsupported by the record. The court of appeals should not have made such assumptions because "credibility determinations, the weighing of evidence, and the

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investment, aggregating $3,100,000. The proceeds remaining are distributable to the Class B Debenture holders pro rata (Ex. 1). The pertinent language of the Class B Debentures is that "any of such net proceeds remaining after such payments (aggregating $3,100,000) shall be distributed pro rata to and among the holders of this series of Class B Debentures". This proof completely destroys the plaintiffs-appellants' conclusion at page 22 of their brief to the effect that such proceeds must go the holders of the common stock.

The argument made by the GB&W obviously presumed that the GB&W was or in the future would be worth more than $10,100,000 since there could be no "such proceeds" until after $10,100,000 was distributed to the three classes of equity securities. The GB&W's argument clearly was that the proceeds in excess of $10,100,000 belonged to the Class B debenture holders and that the common stockholders were entitled only to a return of their original investment of $2,500,000 in the aggregate. (Appellants' Appendix in the Seventh Circuit at A-289) This argument of the GB&W in *Biltchik* clearly supports the Petitioners' interpretation of the Class B debentures herein.

[14] The court of appeals admitted that it did not know whether the value of the GB&W "attained a net value of $10.1 million" (App. A 8a) yet it assumed values under $10.1 million for purposes of its analysis. Its assumptions obviously were not made in a light most favorable to Petitioners. Such a procedure is improper.

drawing of legitimate inferences from the facts are jury functions, not those of a judge, whether he is ruling on a motion for summary judgment or for a directed verdict." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. at 255. In positing its assumption, the court of appeals' reasoning necessitated that it ignore and thus denigrate the holding of the Wisconsin Supreme Court in *Biltchik v. GB&W*, 250 Wis. 177, 26 N.W.2d 633 (1947). The Wisconsin Supreme Court—considering the Class B debenture as a contract document—emphasized that the first two sentences of the Class B debenture "must" be considered and found:

> One [provision] provides that nothing shall ever be paid on the principal until sale or reorganization . . . and after payment of any lien and charges . . . "payment of $600,000 to the holders of the * * * (the Class A Debentures) and the sum of $2,500,000 to the stockholders" . . . "such net proceeds remaining shall be distributed *pro rata* among the holders of the Class B Debentures."

It then held:

> This as to distribution on liquidation puts the holders of the Class B Debentures on the footing of stock holders of an ordinary corporation. It makes them, instead of the stock holders, the owners of the equity of the corporation.

26 N.W.2d at 635. The Wisconsin Supreme Court, in using the term "the equity" with respect to the Class B debenture, and comparing the unusual financial structure of the GB&W to "an ordinary corporation," was referring to the equity which is last in line after the other equity holders had received their interests. The court of appeals dismissed the holding of the *Biltchik* court as not material because the court of appeals presumed that the market value of the GB&W securities was less than $10.1 million at the time of the decision.[15] App. A 9a. However, the

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[15] However, almost every investor involved in buying or selling companies agrees that the market value of a company's securities

*Biltchik* court specifically determined from company records that the railroad had unmortgaged assets of $13,760,000 and liabilities of $560,000. Thus, according to the *Biltchik* court the railroad was valued at $13,200,000 and that court determined, as a consequence, that the "residual equity" belonged to the Class B debenture holders. Petitioners were entitled to an inference by the court of appeals that the Wisconsin Supreme Court's decision confirming the GB&W's argument was based on a valuation in excess of $10,100,000.

The court of appeals concluded in the case at bar that the defendants should prevail because the court presumed that the stockholders would have no incentive to maximize the value of the GB&W after it became worth more than $3.1 million if the residuum belonged to the Class B debenture holders. App. A 8a. Its assumption ignores the practicalities of the factual situation present. Here, the owners of the common stock are also owners of Class B debentures. Itel owned 99.9% of the stock and 78% of the Class B debentures. The court of appeals also failed to consider the fact that the holders of a controlling block of common stock could receive up to a 12.5% return on their original $1,000,000 investment paid at the foreclosure sale in 1896 through annual dividends, provided that the previous year's net income was sufficient to do so. (The 12.5% effective return is equivalent to a return of 5% on the $2,500,000 par value of the stock.)[16] Thus, if their return from the GB&W stock was greater than or commensurate with what they could receive from other investments—bearing in mind that the controlling shareholders also had perquisites and other

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is usually different from the "value" placed on a company by the investor especially if the investor has a better understanding of a company's market value than others in the general public.

[16] Inasmuch as the railroad and property of the predecessor company was purchased at a foreclosure sale for a total price of $1,000,000, the GB&W's stockholders' annual return on the purchase price would be as much as 12.5% on their original investment in the new company.

advantages accruing including positions of importance with the GB&W—it is easy to understand why the controlling stockholders would remain stockholders of the GB&W even though they were limited to $2.5 million in the aggregate upon the sale or reorganization of the railroad. Finally, the court of appeals never factored into its "value-analysis" the stockholders' ability to sell "control" at a premium, or, to continue to control the railroad and operate it as they desired to maximize its value in order to assure the payment of a $5 per share annual dividend. The court of appeals simply presumed that there were no facts in existence which could explain a valid economic reason for the stockholders to refrain from selling the GB&W when it became worth more than $3.1 million (including $600,000 for the Class A debentures) if the stockholders were limited to $2.5 million upon sale or reorganization. The court of appeals further presumed that there was only one, only its, explanation as to why the controlling stockholders would remain invested in the GB&W.

The court of appeals also failed to consider the fact that the market value of the GB&W was not of prime importance to Itel because Itel (which paid a premium for control) intended to and did use the GB&W in such a way (i.e., as to enter into railcar leases with the GB&W that brought huge revenues to Itel) that its benefits to Itel had great value in addition to the market value of the GB&W's securities. The issues presented by this lawsuit could not be decided properly by any court without allowing discovery to be undertaken and the record fully developed.

The Petitioners did not receive the due process protections intended by the Federal Rules of Civil Procedure, and there is a substantial need for this Court to clarify the extent to which the lower courts are authorized to convert, *sua sponte*, a Rule 12(b)(6) motion to dismiss into a motion for summary judgment and to establish the minimum protections required concerning notice and dis-

covery. The court should grant review here to provide needed guidance relating to Rule 12(b), Rule 56(c) and Rule 56(f).

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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# APPENDICES

## APPENDIX A

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

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No. 95-3458

AXEL N. ELIASEN, ROBERT V. ROLLHEISER,
and ALLAN L. APTER, on behalf of themselves
and all others similarly situated,
*Plaintiffs-Appellants,*

*v.*

ITEL CORPORATION, *et al.*,
*Defendants-Appellees.*

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Appeal from the United States District Court for the
Northern District of Illinois, Eastern Division
No. 94 C 4601—Robert W. Gettleman, *Judge*

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ARGUED APRIL 4, 1996—DECIDED APRIL 29, 1996

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Before POSNER, *Chief Judge,* and KANNE and EVANS, *Circuit Judges.*

POSNER, *Chief Judge.* Three years ago Itel Corporation, which owned all the common stock plus 78 percent of the Class B debentures of the Green Bay & Western Railroad Company, sold the railroad. The owners of the remaining Class B debentures, who are the plaintiffs in this class action against Itel, claim to be entitled to share

in the proceeds of the sale over and above the $1,000 face value of each debenture that they received when, in accordance with the terms of their debenture certificates, the debentures were repaid out of the proceeds of the sale. They argue that in refusing to honor their claim Itel has converted property that is rightfully theirs, in violation of both federal and state law under a variety of legal theories unnecessary to discuss. The district judge granted Itel's motion to dismiss, ruling that the debentures did not entitle the holders to more than $1,000 per debenture. If the ruling is correct, the suit has no merit and was properly dismissed without regard to the defendant's numerous other defenses. This is so even though the plaintiffs also complain about Itel's refusal, before it sold the railroad, to credit (more precisely, to cause the railroad, which it controlled, to credit) any of the railroad's income to the Class B debentures. But this complaint, at least as the plaintiffs formulated it in the district court—and it is too late for them to recast the theory of their case on appeal—hinges on their contention that they are the residual claimants to the proceeds of the sale. They say the residuum would have been greater had Itel properly applied the income to the improvement of the railroad rather than (as the plaintiffs allege it did) siphoning that income into the pockets of Itel's shareholders. If the debenture holders had no rights in the residuum, they were not harmed by the siphoning.

A debenture, as the word is normally used in the legal and financial communities of the United States, and as it was normally used a century ago as well, when the debentures involved in this suit were first issued, is a type of bond, specifically a bond unsecured by a lien. Richard A. Brealey & Stewart C. Myers, *Principles of Corporate Finance* 597 (4th ed. 1991); William Z. Ripley, *Railroads: Finance & Organization* 142 (1915). Ordinarily, when a corporation is sold, the proceeds above what is needed to pay off creditors, including bondholders—including therefore debenture holders—go to the sharehold-

ers, as the residual claimants to the corporation's assets. The plaintiffs argue that, contrary to the norm, the Class B debentures in the Green Bay & Western Railroad Company were intended to be the equivalent of shares of stock, while the shares of stock were intended to be the equivalent of debentures. They ask us to look behind the labels that these instruments bear to the economic reality.

Each debenture certificate is a contract between the railroad and the debenture holder, and parties to a contract can agree to use words in a nonstandard sense. But it does not help the plaintiffs' case that they are unable to direct us to any other instance in U.S. corporate history in which the word "debenture" has been used to denote an equity interest. Convertible debentures, that is, debentures convertible into stock upon the coming to pass of stated conditions, have by virtue of their conversation feature an equity hue; but the debentures issued by the Green Bay & Western Railroad are not convertible. A treatise gives an example of where the term "debenture" has been interperted to mean preferred stock. 6 *Fletcher Cyclopedia of the Law of Private Corporations* § 2649.1, p. 27 (1989 rev. ed.). But there is much less space between a conventional debenture and preferred stock than between a conventional debenture and common stock, since preferred stock normally is "maxed out" at its stated par value, 11 *id.* at § 5303, p. 592, just like the Class B debentures if Itel's interpretation is accepted.

To determine whether the interpretation is correct requires an examination of the history and terms of the securities. The Green Bay & Western Railroad was created, under a different name, in 1866. It went broke ten years later and again in 1888, emerging from the second bankruptcy exactly one century ago, in 1896, with a radically new capital structure. The first mortgagees, who had foreclosed on the railroad's property, received all the capital stock of the new company—25,000 shares with a par value of $100 each. The second mortgagees and old shareholders received the Class B debentures—7,000

debentures each with a face value, as we have said, of $1,000—and also, in exchange for investing $600,000 of new money, 600 Class A debentures with a face value of $1,000 each. None of the three classes of securities specified either maturity dates or a fixed entitlement to income, and only the capital stock had voting rights.

Although the debentures do not create a fixed entitlement to interest or dividends, they do provide for the allocation of any annual dividends that the board of directors decides to declare. The dividends are to go to the holders of the Class A debentures until those investors have received 2.5 percent of the face value of the debenture, then to the shareholders until they have received 2.5 percent of the par value of their stock, and then to the holders of the Class A debentures and the shareholders, pro rata, until the two groups have received a total of 5 percent of the face value of the Class A debentures and of the par value of the stock. Any money left after these distributions is to go to the holders of the Class B debentures. In simplest terms, then, the Class B debenture holders are entitled to any dividends that exceed what is necessary to give the shareholders and the Class A debenture holders 5 percent of the face amount of their securities.

In the event of a sale or reorganization of the company, the Class B debenture certificate specifies the following distribution of the proceeds after payment of all liens and charges: the first $600,000 to the holders of the Class A debentures, the next $2.5 million to the shareholders, and either the rest—or the first $7 million of the rest—to the holders of the Class B debentures. Which it is is the issue in this case.

Each Class B debenture certificate states that the Green Bay & Western Railroad Company

> certifies that this is one of a series of seven thousand of its Class B Debentures, in the sum of ONE THOUSAND DOLLARS each, aggregating in all

> the sum of Seven Million Dollars, *which sum of One Thousand Dollars will be payable to the bearer hereof* as follows: viz., only in the event of a sale or reorganization of the Railroad and property of said Company, and then only out of any net proceeds of such sale or reorganization which may remain after payment of any liens and charges upon such railroad or property, and after payment of Six Hundred Thousand Dollars to the holders of a series of Debentures known as Class A, issued or to be issued, by said Company, and the sum of Two Million Five Hundred Thousand Dollars to and among the stockholders of said Company. *Any such net proceeds remaining after such payments shall be distributed pro rata to and among the holders of this series of Class B Debentures.* [Emphasis added].

Itel argues that the first clause that we have italicized makes clear that the only entitlement of the holders of Class B debentures is to $1,000 per debenture. The plaintiffs argue that the last sentence in the quoted passage, which we have also italicized, makes clear that any proceeds from a sale over and above all liens and charges, $600,000 to the holders of the Class A debentures, and $2.5 million to the shareholders, go to the holders of the Class B debentures, making them in effect the equity owners of the railroad. On Itel's reading the shareholders have a debt-like claim to the par value of their stock (the $2.5 million) that is subordinate only to the other creditor interests (including that of the Class A debentures) but they also have the normal equity interest, which comes into play after the Class B debenture holders are paid their $7 million.

The question of what happens after the Class B debenture holders receive the full face value of their debentures cannot arise unless at the time of sale or reorganization the net value of the company exceeds $10.1 million, the sum of the face or par values of the three classes of secur-

ity. That happy eventuality must have seemed remote in 1896, for the debentures and other documents of the 1896 reorganization do not make clear provision for it. Nevertheless the presumption in 1896 as now was (is) that the residual, unprovided-for value of a corporation belongs to the shareholders rather than to the holders of debentures or other bonds. The first clause that we italicized in the Class B debenture reinforces the presumption, for it states flatly that the holder's right in the event of a sale or reorganization of the railroad is to receive the face amount of the debenture, $1,000. The sentence on which the plaintiffs rely can easily be read as merely specifying the mode of distribution among the Class B debenture holders in what must have seemed the likely event that the proceeds of the sale were insufficient to give them the full $7 million.

It is true that on Itel's interpretation the Class B debenture holders got very little in the reorganization. They got no right to any income unless the board of directors decided to declare a dividend larger than 5 percent of the combined face value of the Class A debentures and par value of the common stock, that is, more than 5 percent of $3.1 million ($155,000). And if the railroad was never sold or reorganized, the debenture holders would never get their principal back. But remember that the recipients of the Class B debentures were the junior mortgagees, and the shareholders, of a bankrupt railroad. They may have gotten little in exchange for the surrender of their interests in the railroad because those interests were worth little. *Eliasen v. Green Bay & Western R.R.*, 569 F. Supp. 84, 90 (E.D. Wis. 1982), aff'd without opinion, No. 82-2502 (7th Cir. March 11, 1983). The junior mortgagees had not been paid anything on their mortgages for the fourteen years preceding the reorganization. *Leuw v. Green Bay & Western R.R.*, No. 89-CV-53, slip op. at 6 (Wis. Cir. Ct. Feb. 1, 1993). To the extent that these investors did not merely exchange their old interests for new ones but also contributed new value to the railroad,

as they did, they were compensated by receiving Class A debentures. Those debentures were entitled to priority both in the distribution of the railroad's income and in the eventuality of a sale or reorganization. The new shareholders, having in their previous capacity as first mortgagees already foreclosed on the railroad, received both voting control and a bond-like entitlement to $2.5 million in the event that a sale or reorganization yielded net proceeds after all liens and charges of at least $3.1 million, plus (on Itel's interpretation) what must have seemed the remote possibility of an additional return should the railroad be sold and reorganized at a time when it had attained a net worth in excess of $10.1 million.

Itel's interpretation makes better economic sense than the plaintiffs' because it is more consistent with the creation and maintenance of proper incentives for operating the railroad in such a way as to maximize its value. (This is relevant because most commercial transactions are designed to be value-maximizing.) Only the shareholders had been given voting rights. Only the shareholders, therefore, could control the management of the corporation. If they had no right to any part of the gain from increasing the value of the corporation above $3.1 million, the level that would just cover their fixed entitlement to $2.5 million, they would have had little zeal for developing the railroad to the level it reached when it was sold in 1993. We do not know the sale price, because Itel sold the Green Bay & Western Railroad together with another railroad for a combined price of $64 million. The plaintiffs claim that $43 million is the *minimum* amount of the sale price fairly allocable to the Green Bay, which if so would entitle the Class B debenture holders, under the plaintiffs' theory of the case, to roughly $40 million. The plaintiffs, recall, own 22 percent of those debentures.

A corporate structure in which the bondholders, for that is what the plaintiffs think the shareholders are—

holders of 25,000 bonds worth $100 apiece—have all the voting rights, and the shareholders, who are what the plaintiffs consider the Class B debenture holders to be, have no voting rights, is anomalous. See Frank H. Easterbrook and Daniel R. Fischel, "Voting in Corporate Law," 26 *J. Law & Econ.* 395, 403-05 (1983). And yet this inverted corporate structure would not be crazy if at the time it was created the possibility that the railroad would ever be worth at least $10.1 million was so remote that the shareholders, even if they were the residual claimants, would have no incentive to maximize the value of the railroad, beyond trying to create a cushion to protect their $2.5 million bond-like entitlement. As Easterbrook and Fischel point out, corporate indentures frequently shift voting rights to creditor groups when financial distress attenuates the shareholders' interests and makes the creditors the de facto residual claimants to the value of the corporation's assets. *Id.* at 404-05. Throughout most of the history of the railroad it has been the Class B debenture holders who have been the real equity owners, because until the railroad attained a net value of $10.1 million (which for all we know has not yet occurred) any increase in value would enure to the benefit of those investors. But this is an argument for having given the Class B debenture holders the voting rights and hence control of the corporation, which the reorganization plan and the debenture certificates did not do. The only way to give the shareholders a robust incentive to maximize the railroad's value is to give them an equity kicker above the Class B debenture holders' entitlement, and so the debenture contract can be presumed to have done this.

Another reason to doubt that the debenture holders received an equity interest is that the shareholders, being in control of the corporation as a consequence of their voting rights, could so easily circumvent that interest. Before a sale or reorganization of the railroad the value of the debentures would be depressed because the holders

would have no right to force either a sale of the railroad or a declaration of dividends in an amount that would give any part of the railroad's income to the debenture holders. The owners of the stock could therefore buy up the debentures cheap, so that, when the railroad was sold, the stockholders (now also the debenture holders) would obtain the benefits of the equity interest nominally held, under the plaintiffs' interpretation, by the debenture holders. And indeed when Itel bought the railroad's common stock it also bought 78 percent of the Class B debentures.

So uncertain was the right of the debenture holders to income from the corporation that the Tax Court ruled, in a decision upheld by this court in *Green Bay & W.R. Co. v. Commissioner*, 147 F.2d 585 (7th Cir. 1945), that the railroad could not deduct payments to either class of debenture holders as interest. Instead it had to treat these payments for tax purposes as dividends (the term, as it happens, used in the debentures themeslves). But this is just to say that the debenture holders have no interest entitlement. It does not address the question of their entitlement in the event of a sale. This is obvious from the fact that the court treated the Class A debenture holders the same as the Class B holders, even though it is indisputable that the former are entitled only to the face value of their debentures in the event of a sale.

So the tax case cannot do much for the plaintiffs and neither can *Biltchik v. Green Bay & W.R. Co.*, 26 N.W.2d 633 (Wis. 1947), despite its tantalizing dictum that the provision "as to distribution on liquidation puts the holders of the Class B Debentures on the footing of stockholders of an ordinary corporation. It makes them, instead of the stockholders, the owners of the equity of the corporation." *Id.* at 635. The issue in *Biltchik* was whether the railroad's board of directors had any duty to declare a dividend large enough to give the Class B debenture holders some income. The court held that the board had no such duty as long as it used the railroad's

income for proper purposes. The court pointed out that the Class B debenture holders might benefit indirectly if the railroad rather than paying generous dividends plowed back its earnings into improvements, since that would make the railroad worth more in the event it was sold. If the railroad was already worth $10.1 million, such improvements would not benefit the Class B debenture holders directly if their entitlement in the event of a sale or reorganization is capped at $7 million, although it would do so indirectly, by increasing the probability that they would be paid in full should the railroad ever be sold. But it is fairly plain that the railroad was worth much less than $10.1 million at the time of *Biltchik*. See *id.* at 635. So the cap was not material and the court's passing remark about the status of the Class B debenture holders cannot be considered authoritative.

Even if as we believe Itel has the better of the argument when consideration is limited to the text of the Class B debenture, should consideration be so limited? Since the debenture makes no explicit provision for the allocation of the net proceeds of sale above $10.1 million, and since the last sentence that we quoted from the debenture certificate, the sentence on which the plaintiffs pitch their case, provides at lease some support for it, there is enough ambiguity to permit the consideration of extrinsic evidence, that is, evidence outside the text of the Class B debenture itself. Itel implicitly acknowledges this by pointing out that these debentures were issued in exchange for interests that probably had little value.

The first item of extrinsic evidence that the plaintiffs want us to consider is the text of the Class A debenture. It is almost identical to that of the Class B debenture, except that the first sentence of the Class A debenture, of course, states the entitlement of the holders of that debenture to *their* $1,000 rather than the entitlement of the Class B debenture holders to their $1,000. Like the Class B debenture, the Class A debenture goes on to specify the order of distribution, including the payment

to the holders of the Class B debentures of the surplus over the Class A debenture holders' and the shareholders' entitlements. Since the first sentence of the Class A debenture does not mention the Class B debenture holders, there is nothing to qualify the last sentence—the sentence that taken by itself appears to give the entire surplus, with no $7 million cap, to those debenture holders. That sentence does not appear, however, in the description of the Class A debentures that appears in the articles of incorporation of the reorganized firm. And to the holder of a Class A debenture the only important thing is his entitlement, and not, after his entitlement has been satisfied, how any surplus above the amount necessary to satisfy it is to be divided between other classes of investor. It would be odd for the owner of a Class B debenture to look to the text of *another* debenture for the statement of his rights (though, granted, initially the holders of the two classes of debentures were the same people—the railroad's second mortgagees and former shareholders). No one reading the Class B debenture, with its flat statement that it entitles the holder to $1,000 if the railroad is ever sold or reorganized, would suppose that it entitled the holder to more—to almost six times as much, in fact, if the plaintiffs' estimate of the sale price of the railroad is correct.

The plaintiffs point to a series of statements that the railroad made, some in the two cases that we discussed, some in other cases, others in submissions to the SEC and the ICC, which the plaintiffs construe as admissions that the Class B debenture holders are the residual owners of the railroad. So far as appears, however, these statements (contradicted, incidentally, by others, which do refer to the $7 million cap) were made at a time when the railroad was worth less than $10.1 million, so that the question of the entitlement to any surplus value above that was academic. In the 1940s, when *Biltchik* and the tax case were decided, the market value of the Class B debentures was only $120, implying that the net worth of

the railroad may have been as little as $3,940,000 ($.6 million plus $2.5 million plus 7,000 × $120). If so, the Class B debenture holders were the real equity owners, because, had the railroad been sold then at that price, they would have received the entire net proceeds minus the $3.1 million reserved for the Class A debenture holders and the shareholders.

Despite what we have just said, the value of the railroad cannot be inferred directly from the market value of the Class B debentures. That market value would have been depressed by the inability of the debenture holders to force a sale or a distribution of income to them. The court in *Biltchik* thought the railroad worth more, about $5 million—or so we infer from 26 N.W.2d at 635. This estimate may well have been more realistic. But it is still far below the point at which the Class B debenture holders would be paid in full in the event the railroad was sold.

The plaintiffs presented no evidence of the value of the railroad at any of the times when the statements on which they rely were made, although it appears that as late as 1986 the railroad was worth no more than $8.4 million. *Leuw v. Green Bay & Western R.R.*, *supra*, slip op. at 21, 48. Itel had acquired its interest in the railroad—100 percent of the common stock and 78 percent of the Class B debentures—in 1978 for a total of $8 million. (Because it had bought securities of the railroad rather than the railroad itself, its purchase did not trigger the entitlement of the debenture holders to be paid out.) The plaintiffs' claim that the railroad was sold for at least $43 million in 1993 appears to be grossly exaggerated. Itel had paid $61 million for the Fox River Valley Railroad, the railroad it sold together with the Green Bay & Western Railroad for $64 million in 1993.

Remarks, even considered statements, that the Class B debenture holders were the real equity owners of the Green Bay, made at the time when they *were* the real

though not formal equity owners, are not highly probative of what their status would be if the residual value of the railroad rose above the face amount of those debentures. The plaintiffs want a trial but have cited no evidence that would rebut the presumption from the text and history and economic logic of the Class B debenture that it caps the holder's entitlement at $7 million. No jury would be permitted to speculate that this debenture was really a share of stock.

Yet the thrust of our analysis has been that Itel was entitled to summary judgment, not that the complaint should have been dismissed for failure to state a claim. While a court, either the district court or the court of appeals, can grant summary judgment even though neither party has moved for it, it must not do so without giving the party against whom the court proposes to enter summary judgment notice of what is in store for that party. *Resolution Trust Corp. v. Ruggiero*, 994 F.2d 1221, 1226 (7th Cir. 1993). But this is not a problem here. The plaintiffs have laid out their extrinsic evidence —the evidence they think creates a triable issue—in full in their briefs in this court and Itel has explained why it thinks that the plaintiffs' evidence does not create a triable issue. This is equivalent to Itel's arguing that if it was not entitled to dismissal under Rule 12(b)(6) it was entitled to summary judgment. The plaintiffs had, and have availed themselves, of the opportunity to reply to the argument. In effect the parties have recast the issue on appeal as whether we should grant summary judgment for the defendant. We should and do. The judgment is therefore

AFFIRMED.

A true Copy:

Teste:

Clerk of the United States Court of
Appeals for the Seventh Circuit

**APPENDIX B**

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago, Illinois 60604

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Dated: April 29, 1996

Before: HONORABLE RICHARD A. POSNER, Chief Judge
HONORABLE MICHAEL S. KANNE, Circuit Judge
HONORABLE TERENCE T. EVANS, Circuit Judge

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No. 95-3458

AXEL N. ELIASEN, ROBERT V. ROLLHEISER and ALLAN L. APTER, on behalf of themselves and all others similarly situated,
*Plaintiffs-Appellants*

v.

ITEL CORPORATION, a Delaware Corporation, ITEL RAIL CORPORATION, formerly known as ITEL RAIL CAR DIVISION, a Delaware Corporation, HOWARD L. CHABNER, *et al.*,
*Defendants-Appellees*

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Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division
No. 94 C 4601, Robert W. Gettleman, Judge

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JUDGMENT—WITH ORAL ARGUMENT

The judgment of the District Court is AFFIRMED, with costs, in accordance with the decision of this court entered on this date.

**APPENDIX C**

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

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No. 94 C 4601

JUDGE ROBERT W. GETTLEMAN

AXEL N. ELIASEN, ROBERT V. ROLLHEISER and ALLAN L. APTER, on behalf of themselves and all others similarly situated,

*Plaintiffs,*

v.

ITEL CORPORATION, a Delaware Corporation, ITEL RAIL CORPORATION (f/k/a Itel Rail Car Division), a Delaware Corporation, HOWARD L. CHABNER, JAMES CHANDLER, ROD F. DAMMEYER, JACK P. EDWARDS, DESMOND HAYES, WILLIAM J. HERNDON, GARY M. HILL, CURTIS J. HOCKADAY, ROBERT C. KIEHNLE, JAMES E. KNOX, PAUL L. LOVEDAY, CARL V. LYON, CHARLES D. MARTIN, SAMUEL ZELL, THOMAS O. KLOEHN, and QUARLES & BRADY,

*Defendants.*

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MEMORANDUM OPINION AND ORDER

Plaintiffs, Axel N. Eliasen, Robert V. Rollheiser and Allan L. Apter, on behalf of themselves and all others similarly situated, bring this eighty-two page, nine count putative class action complaint against defendants Itel Corporation ("Itel"), Itel Rail Corporation ("Itel Rail"), Howard L. Chabner, James Chandler, Rod F. Dammeyer, Jack P. Edwards, Desmond Hayes, William J. Herndon, Gary M. Hill, Curtis J. Hockaday, Robert C. Kiehnle,

James E. Knox, Paul L. Loveday, Cary V. Lyon, Charles D. Martin, Samuel Zell ("the Individual Defendants"), and Thomas O. Kloehn and Quarles & Brady, alleging violations of the federal RICO statute, 18 U.S.C. § 1962 (a), (c), (d); Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 17(j); and state common law claims of breach of fiduciary duty, tortious interference with contract, conversion of property rights, accounting, as well as a claim for declaratory judgment. Federal jurisdiction is based on the RICO counts, 18 U.S.C. §§ 1964(a), (c), and 28 U.S.C. § 1331. All defendants have moved to dismiss all counts pursuant to Fed. R. Civ. P. 12(b) (6) for failure to state a claim upon which relief can be granted, and pursuant to Fed. R. Civ. P. 8(a)(2) and 9(b) for failure to set forth a short plain statement of the claim and failure to plead fraud with particularity. For the reasons set forth below, defendants' motions are granted and the case is dismissed.

## INTRODUCTION

This is the latest (and hopefully the last) chapter in a long saga involving the rights of the holders of Class B debentures of the Green Bay & Western R. R. Co. ("GB&W"). Plaintiffs are all holders of Class B debentures who claim that pursuant to the wording of the securities issued by GB&W, as well as the Articles of Incorporation, they, as holders of Class B debentures, are entitled to a *pro rata* distribution of the net proceeds of the recent sale of GB&W. Plaintiffs claim that defendants, through a series of schemes, sought to destroy the value of the Class B debentures.

Defendant Itel is a Delaware corporation engaged in various businesses through its subsidiaries. Defendant Itel Rail is a wholly owned subsidiary of Itel that leases rail cars, and manages various short line railroads. In 1983, Itel, which owned 99.9% of the GB&W capital stock and a majority of the GB&W Class B debentures,

transferred all of its railroad operation to Itel Rail, including the GB&W capital stock and the GB&W Class B debentures. The individual defendants are all current or past officers and/or directors of Itel, Itel Rail, or GB&W. Defendant Kloehn is an attorney with the Wisconsin law firm of Quarles & Brady ("Quarles"), which plaintiffs allege represented GB&W and Itel at all relevant times, and who were aware of the alleged scheme to defraud the Class B debenture holders and advised and counseled Itel and Itel Rail with respect to many of the alleged wrongful acts.

Plaintiffs claim that as holders of Class B debentures they are the true owners of the equity of GB&W, and that defendants have concocted various elaborate schemes to destroy the value of the Class B debentures such that their actual value never exceeded their face value. To accomplish this goal, plaintiffs allege that defendants developed schemes to: (1) fraudulently deprive the minority holders of Class B debentures of their right to receive payments out of annual net income of GB&W; (2) fraudulently misuse the monies withheld from the Class B debenture holders by "loaning" said monies to Itel; (3) materially decrease the value of the GB&W securities by withholding the payments due out of annual income so that the securities could be purchased at artificially low prices; (4) fraudulently transfer approximately $10 million of GB&W's operating assets' "value" to another railroad owned by Itel, so as to deny the minority Class B debenture holders their full equity value in GB&W; (5) fraudulently deny the minority Class B debenture holders the value of that part of the equity of GB&W to which the Class B debenture holders were entitled, which exceeded the $1,000 face amount of the Class B debentures; (6) fraudulently misrepresent to the Class B debenture holders, the state and federal governments, and state and federal courts through the use of the U.S. mail, the rights of the Class B debenture holders and the value of the Class B debentures in order that Itel

could obtain possession of the Class B debentures at prices drastically below the face value; and (7) cause GB&W to lease rail cars from Itel on terms overly favorable to Itel and extremely unfavorable to GB&W, which reduced the annual net income of GB&W, reduced the value of the GB&W, and in turn reduced the value of the Class B defentures.

According to the complaint, in 1993 Itel Rail sold the GB&W assets and property to Wisconsin Central Transportation Corp. ("Wisconsin Central"), along with the assets of the Fox River Valley Railroad ("FRVR"), which was wholly owned by Itel Rail. At the time of the sale, Itel Rail owned 99.9% of the outstanding capital stock of GB&W, but only 78% of the Class B debentures. Plaintiffs allege that from the time Itel acquired GB&W in late 1978, until the time it sold GB&W, Itel sought to destroy the value of the Class B debentures by reducing the value of the GB&W assets. In addition, plaintiffs allege that Itel put into place a scheme to change the nature of the Class B debentures from equity status, which plaintiffs claim they enjoy under *Green Bay & W. R. Co. v. Commissioner of Internal Revenue,* 147 F.2d 585 (7th Cir. 1945), and *Biltchik v. Green Bay & W. R. Co.*, 250 Wis. 177, 26 N.W.2d 633 (1978), to debt status.

## BACKGROUND [1]

To understand the nature of plaintiffs' complaint, it is necessary to review the history of GB&W, the history of the Class B debentures, and the history of the litigation surrounding those debentures.

From 1871 through 1873, Green Bay & Lake Pepin Railway Company built the railroad that is the subject of this lawsuit. In 1873, that company changed its name to the Green Bay & Minnesota Rail Road Company. On

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[1] This history is taken from *Eliasen v. Green Bay & W. R. Co.*, 569 F. Supp. 84 (E.D. Wis. 1987) (*"Eliason I"*).

January 23, 1876, the Green Bay & Minnesota went into receivership, and the mortgage bondholders foreclosed on their mortgages. On May 16, 1881, a committee of the mortgage bondholders chartered the Green Bay, Winona & St. Paul Railway Company, which purchased the property of the Green Bay & Minnesota at a foreclosure sale. That company defaulted on the interest payments due on its first mortgage bonds on August 1, 1888, and went into receivership on July 31, 1890. A voluntary reorganization agreement was reached in 1892, but proved unsuccessful. On December 27, 1895, another foreclosure sale was ordered. At that sale in May 1896, a committee for the first consolidated mortgage bondholders purchased the property of the railroad.

On May 27, 1896, the GB&W charter was issued. That charter embodied a plan of reorganization between the securities holders of the Green Bay, Winona & St. Paul Railway Company. The members of the first consolidated mortgage bond committee were identified as the purchasers of the railroad and property and as the incorporators and first board of directors of GB&W. The articles of incorporation provided for three types of securities: $2,500,000 of $100 par value capital stock; $600,000 of $1,000 face value Class A debentures; and $7,000,000 of $1,000 face value Class B debentures.

The 25,000 shares of capital stock were distributed to the first mortgage and first consolidated mortgage bondholders of the Green Bay, Winona & St. Paul Railway Company. The 7,000 Class B debentures were to be distributed to the holders of the second mortgage income bonds and to the holders of the common and preferred stock of the Green Bay, Winona & St. Paul Railway, after the committee of the second mortgage income bonds and preferred and common stockholders of the Green Bay, Winona, St. Paul purchased the 600 Class A debentures for $570,000 in cash.

None of the three classes of securities have a fixed rate of return, and any annual payments that might have been paid are not cumulative. None of the securities have a maturity date; but the Class A and Class B debentures are payable only in the event of a sale or reorganization of the railroad and property of the company. Only the capital stock has voting power.

The capital structure of GB&W has remained unchanged since it was created in 1896. In January 1978, Itel acquired the GB&W through an amended tender offer. At that time, Itel acquired more than 97% of the outstanding common stock, more than 4,919 of the 7000 Class B debentures, and two of the three outstanding Class A debentures. The terms of the amended tender offer were $330 per share of common stock, $1,050 per Class A debenture, and $325 per Class B debenture.

## HISTORY OF THE CLASS B DEBENTURES

As noted by Chief Judge Reynolds in *Eliasen I* (569 F. Supp. at 88):

> The Class B debentures are an unusual security that cannot easily be classified. The rights that the holders of Class B debentures enjoy cannot be ascertained merely by referring to the terms of the instrument and the GB&W's articles of incorporation. Interpretation of their rights requires an understanding of the circumstances surrounding the organization of the GB&W in 1896, and of the litigation that has already occurred over these debentures.

The unusual capital structure of the GB&W, and two terms contained in the Class B debentures in particular, have spawned a series of lawsuits. One of those terms provides that the Class B debenture is subordinate to the capital stock and Class A debentures for purposes of distribution of annual income. Specifically, with respect to annual income, the debenture provides:

> The holders of this series of Debentures shall in lieu of interest thereon participate in the distribution of annual net income to the following extent only: viz., so much of the annual net earnings of the said Company in any year as would be applicable to the payment of dividends on stock shall be applied as follows: viz., to the holders of a Class A debenture 2-½% upon the face value thereof, or if such annual net earnings are insufficient for the payment of the same, then all such net earnings shall be distributed pro rata among the holders of said Class A debentures. After payment of 2-½% upon the face value of Class A debentures, the stockholders of the Company are entitled to receive the balance of such net earnings until 2-½% have been paid out of the same upon the par value of said stock, and all surplus net earnings then remaining shall be paid to the holders of Class A debentures and of the stock, pro rata, until 5% shall have been paid upon the face value of said Debentures, and upon the par of said stock for such year, and any surplus net earnings arising in such year which may then remain shall be paid to and distributed among the holders of the Class B debentures pro rata. None of such payments shall be cumulative. The amounts, if any, payable upon this series of Debentures out of the net earnings in any year, will be fixed and declared by the board of directors . . . .

The second term deals with repayment of the debenture upon maturity. The debentures do not have a specified maturity date, but rather mature only upon a sale or reorganization of the railroad and property of the company. Specifically, the Class B debentures provide:

> The Green Bay & Western Railroad Company hereby certifies that this is one of a series of 7,000 of its Class B Debentures, in the sum of ONE THOUSAND DOLLARS each, aggregating in all the sum of Seven Million Dollars, which sum of One Thou-

> sand Dollars will be payable to the bearer hereof as follows: viz., only in the event of a sale or reorganization of the Railroad and property of said Company, and then only out of net proceeds of such sale or reorganization which may remain after payment of any liens and charges upon such Railroad or property, and after payment of Six Hundred Thousand Dollars to the holders of a series of Debentures known as Class A, issued or to be issued, by said Company, in the sum of Two Million Five Hundred Thousand Dollars to and among the stockholders of said Company. Any such net proceeds remaining after such payments shall be distributed pro rata to and among the holders of this series of Class B debentures.

The first litigation arising out of the Class B debentures was reported in *Green Bay & Western Railroad Company v. Commissioner of Internal Revenue,* 147 F.2d 585 (7th Cir. 1945). In that case, the issue was whether amounts paid to the holders of Class A and Class B debentures by the GB&W from its annual income should be treated as interest or dividends under the income tax laws. After reviewing the wording of the debentures, the court held that the amounts paid were dividends. In so doing, the court stated:

> The debentures on their face disclose that they had no fixed maturity; that the dividends were not cumulative and were payable within the discretion of the board of directors; that there was no provision for interest on unpaid dividends; that the debenture holders had no right to maintain an action in case of default as to the payment of dividends inasmuch as such payment was in the discretion of the board of directors; that the status of the debenture holders of Class A was on a par with that of stockholders; and the rights of the debenture holders both Class A and Class B were inferior to those of creditors.

> Moreover, investments in the debentures represent value paid in at the time of the petitioner's incorporation and constitute a large part of its operating capital. Furthermore, the investments can be withdrawn only at the dissolution of the corporation, they are subject to the hazards of the business and in our opinion may properly be designated as a part of the capital structure.

*GB&W v. C.I.R.*, 147 F.2d at 586-87.

This broad language is the basis of plaintiffs' initial argument that the Class B debentures are more in the nature of stock than debt, and that the debenture holders are entitled to the equity (at least in part) of the company. As noted in *Eliasen I*, however, despite its inclusion of such broad language, the court's holding in *GB&W v. C.I.R.* was quite narrow, limited solely to the determination of how the annual payments to debenture holders should be characterized for income tax purposes.

In 1947, the Wisconsin Supreme Court in *Biltchik*, 250 Wis. 177, faced the question of whether the Class B debenture holders could compel the GB&W to make annual payments out of net income. The court held that any annual payment to the Class B debenture holders was discretionary with the board of directors, and affirmed the trial court's decision that the board had not abused that discretion. In reaching that conclusion, the *Biltchik* court reviewed both the circumstances surrounding the creation of the Class B debentures as well as its terms. With respect to the 1896 reorganization, the court specifically found:

> It is clear from the undisputed evidence that had the foreclosure suit proceeded in the common course of practice to sale of the mortgaged property neither the holders of the second-mortgage bonds nor the stockholders of the old company would have received anything. The scheme of reorganization was mani-

> festly planned to assure that the holders of the subordinate securities should receive nothing whatever until the holders of the new Class A debentures and the new stock were compensated both through current income and on liquidation of the new corporation. . . .

*Biltchik*, 250 Wis. at 180.

Then, in reviewing the provisions of the Class B debentures regarding distribution on sale or reorganization, the *Biltchik* court stated:

> This as to distribution on liquidation puts the holders of the Class B debentures on the footing of stockholders of an ordinary corporation. It makes them, instead of the stockholders, the owners of the equity of the corporation.

*Biltchik*, 250 Wis. at 181.

This unfortunate statement, neither part of nor necessary to the court's holding, has basically laid the groundwork for over 45 years of litigation. It is these two lines that lead plaintiffs in this case to believe that they are the owners of the equity of GB&W, and that they are entitled to the net proceeds of the sale of GB&W to Wisconsin Central after priority payments made to the Class A debenture holders and the common stockholders.

The issue before the court in *Biltchik*, however, and consequently the holding, had nothing to do with distribution upon a sale or reorganization of the railroad and its property. The sole issue before the court was whether the Class B debenture holders could compel annual payments, and the holding was that they could not. Thus, all that was decided was what rights the Class B debenture holders have to annual income earned by GB&W. This court agrees with the *Eliasen I* court's assessment that the statement in *Biltchik*,

> was made as an analogy in the context of the Court's conclusion that the increased equity of the GB & W will benefit the Class B debenture holders upon pay-

> ment on the bonds. The Court was not concluding the Class B debenture holders enjoyed all the rights of the common stockholders, nor that they were the only security holders with an interest in the equity in the GB & W. Rather, the Court was simply observing that by their terms, the Class B debentures are to be paid out of the equity of the company that remains after payment of prior claims and $600,000 to the Class A debenture holders and $2,500,000 to the capital stockholders.

*Eliasen I*, 569 F. Supp. at 93 (E.D. Wis. 1982).

*Eliasen I* was a class action brought by Axel Eliasen, one of the named plaintiffs in the instant action. In that case, the plaintiffs sued GB&W and its individual directors alleging that the directors breached fiduciary duties to the Class B debenture holders by failing to act on an acquisition proposed by Itel, and then by subsequently recommending acceptance of the Itel tender offer. Plaintiffs further alleged that Itel's subsequent acquisition of GB&W, through an amended tender offer, was a *de facto* sale or reorganization of the railroad and its property entitling the Class B debenture holders to a pro rata distribution of the net proceeds after the priority payments to the Class A and capital stockholders.

After reviewing the history of the Itel acquisition, as well as the organization of GB&W and the terms of the securities and prior judicial decisions interpreting those securities, the *Eliason I* court held that: (1) the tender offer was not a sale or reorganization of the railroad and property and, therefore, the plaintiffs were not entitled to payment on the principal of the debentures; and (2) the individual directors had not breached any fiduciary duties to the Class B debenture holders. The court never reached the issue of what interest the Class B debenture holders have in the equity of GB&W upon a sale or reorganization, but did state that whatever that interest may

be, the "debentures cannot be equated to common stock." *Eliasen I*, 569 F. Supp. at 94.

The latest case arising out of the debentures was *Leuw v. Green Bay & Western Railroad Company*, No. 89 CV 53 (Cir. Ct. Wis. Feb. 1, 1993) (referred to by both parties as "*Drexler*"). In *Drexler*, the plaintiffs, holders of 889 Class B debentures, brought an eleven count complaint against GB&W, Itel, Itel Rail and certain individual officers and directors of GB&W alleging that the defendants, particularly Itel and Itel Rail, engaged in a variety of misconduct including: vitiating the GB&W board of directors; engaging in self-dealing transactions; refusing to declare dividends, thereby causing all earnings of GB&W from 1978 through 1990 in excess of $4,600,000 to be retained by GB&W; siphoning off $7,200,000 in earnings with loans to themselves; siphoning off $17,080,000 of earnings by commercially unreasonable leases; reorganizing GB&W by merging the management of GB&W into the management of FRVR; scheming to siphon off $14,400,000 from GB&W through the pending sale of GB&W to a subsidiary of Wisconsin Central; reorganizing the capital structure of GB&W by changing records and accounts to present the Class B debentures as liabilities in the amount of $1,000 each, and the capital stock as GB&W's only equity security; and scheming to distribute all of GB&W's net assets to the capital stockholders, namely Itel Rail, after payment of $1,000 per Class B debenture and Class A debenture.

After a full trial on the merits, the *Drexler* court found that: (1) the Class B debenture holders do not have any rights as stockholders in GB&W and could not proceed against the defendants in the capacity of stockholders; (2) the plaintiffs were not on the same footing as stockholders of the corporation; (3) because the plaintiffs were not stockholders, the defendants owed them no fiduciary duties with respect to the counts seeking equitable buyout, dissolution, sale or *de facto* merger and breach of fiduciary duty. The court then found that all of the de-

fendants' actions in managing the GB&W from 1978 through 1992 were done with the best interests of GB&W and its security holders in mind and for valid business reasons, including the decisions not to declare dividends or make annual distributions to the Class B debenture holders. *Drexler,* at 54-58.

The *Drexler* court, like the others before it, never reached the question of the extent of the rights of the Class B debenture holders upon sale or reorganization of the railroad and property. Indeed, the court specifically stated that because of its decision it was unnecessary to reach that issue. *Id.* at 59.

It is within this historical context that this court reviews plaintiffs' complaint and defendants' motions to dismiss.

## FACTS

Plaintiffs' nine count, 122 paragraph, 82 page complaint is virtually impossible to summarize briefly. Indeed, it took plaintiffs eight pages to summarize the alleged misconduct of defendants, and the summary presented is disjointed and, frankly, of little value. The complaint is so full of historical context (both of the railroad itself and the litigation surrounding it) that plaintiffs' real allegations get lost in the mess. Most, if not all, of the history is unnecessary to present plaintiffs' claims, and indeed the complaint as a whole totally eviscerates the spirit of Rule 8, and could be stricken for that reason alone.

In essence, plaintiffs claim that beginning in 1978 defendants started an "ongoing criminal enterprise" to acquire what plaintiffs term as all of the GB&W equity-securities. They claim that Itel began a scheme to change the nature of the Class B debentures from equity status (which plaintiffs the claim the courts in *GB&W v. C.I.R.* and *Biltchik* (determined) to debt status, thereby limiting the value of each debenture to $1,000. Plaintiffs also claim that Itel leased GB&W railroad cars to another rail-

road owned by Itel on terms favorable to Itel and unfavorable to GB&W. In addition, plaintiffs claim that in 1993, when GB&W was sold to Wisconsin Central, defendants schemed to understate the value of the assets of GB&W and overstate the value of the FRVR in order to deny the Class B debenture holders their alleged right to their pro rata share of the equity of GB&W. The details of the alleged schemes are set forth in paragraph 60(a) through 60(s), pages 35 through 55 of the second amended complaint, which reiterate many of the same complaints already litigated and decided adversely to the plaintiffs in *Drexler*. Of special note is palintiffs' claim (paragraph 60(s)(1)) that defendants Quarles and Kloehn intentionally misled the *Drexler* court by taking the position that the Class B debentures are debt instruments worth only $1,000 each. The complaint further charges Quarles and Kloehn with mail fraud for writing to the court and plaintiffs to explain that after the sale the net assets of GB&W would be distributed to the capital shareholders. It is these letters, among others, that plaintiffs rely upon for the requisite mailings to support their RICO claims based upon mail fraud.

Some of the specific acts of alleged misconduct upon which plaintiffs base their claims are as follows:

> (a) Itel and Itel Rail with the advice and consent of the individual defendants vitiated the managerial responsibility of the GB&W board of directors by entering into commercially unreasonable leases with GB&W, causing an increase in costs to GB&W and a concomitant reduction in plaintiffs' equity interest. According to the complaint, from 1978 through 1991 GB&W suffered damages in excess of $17,000,000 as a result of such leasing transactions with Itel and Itel Rail, injuring plaintiffs' alleged equity interests;
>
> (b) From 1947 through 1977, following the *Biltchik* decision, GB&W paid out annual income to capital stock and Class A debenture holders every

year, and to Class B debenture holders in "most" years. From 1978 through 1991, however, Itel and Itel Rail, with the advice and consent of the individual defendants and Kloehn and Quarles, have not paid out annual income to Class B debenture holders, and then "siphoned off" $7.2 million in GB&W profits by upstreaming cash to themselves through unsecured loans, without approval of the GB&W board;

(c) From November 1978 through May 1979, GB&W made at least six unsecured loans to Itel totaling $5.2 million, despite Itel's poor financial condition and its eventual filing for bankruptcy;

(d) From 1987 through 1991 GB&W made a series of unsecured loans to Itel and Itel Rail totaling at one point $7.7 million, with $7.2 million outstanding at the end of 1991. Plaintiffs allege that this shows that GB&W had excess cash which was not applied to corporate betterment, as required by *Biltchik*, and which jeopardized plaintiffs' "equity" interests;

(e) From March 1982 through November 1994 (the date the second amended complaint was filed in the instant case) defendants have falsified GB&W's books and records, financial statements and government filings to treat the Class B debentures as debt instruments which give their holders no proprietary interest in GB&W and its equity, and to treat the capital stock as the only equity security. By so doing, according to plaintiffs, defendants have transferred all of GB&W's equity above $1,000 per share of capital stock from the Class B debenture holders to Itel. Specifically, plaintiffs allege that after *Biltchik*, until March 8, 1982, GB&W listed the Class B debentures under the stockholders' equity portion of the balance sheet. In March 1982, defendants altered the books to show the Class B debentures as debt instruments in the amount of $1,000 each. Annual

financial reports sent to stockholders via U.S. mail from 1982 through 1993 indicate the Class B debentures as debt, and "imply" that GB&W is a wholly owned subsidiary of Itel Rail. These books and records, financial reports, and government filings were allegedly used by defendants to deceive creditors by making it appear that Itel and Itel Rail were and are the owners of all GB&W equity, and were presented to banks to acquire loans.

The list presented above is an just an example of defendants' alleged misconduct, and is not intended to be exhaustive. It is representative, however, of the type of misconduct alleged by plaintiffs, all of which center around the defendants' control of GB&W and their actions that allegedly decreased the value of GB&W and thus decrease plaintiffs' alleged equity interests, including the defendants' having sold GB&W to Wisconsin Central at a fraudulently low price.

## DISCUSSION

Both parties agree that the Class B debentures have now "matured" as a result of the sale of GB&W to Wisconsin Central, triggering the disbursement upon liquidation provision of the debentures. Thus, the issue that was never reached in *GB&W v. C.I.R.*, *Biltchik*, *Eliasen I*, and *Drexler*, namely, how much of the proceeds (if any) of the sale are to be distributed to the Class B debenture holders upon liquidation, is now squarely before this court.

The parties disagree, however, as to how much of plaintiffs' complaint rests upon this one issue. Defendants contend that plaintiffs' entire complaint rests on their simple assertion that the Class B debenture holders are entitled to the net assets of GB&W after payment of: (1) all debt and liens; (2) $600,000 to the Class A debenture holders; (3) $2,500,000 to the common stockholders. (Defendants' memorandum in support, p. 33.)

Plaintiffs deny that their entire complaint rests upon this assertion, but do admit that "[t]he asset-distribution provision of the Class A and Class B debentures is a core matter at issue between the parties herein." (Plaintiff Memorandum in Opposition ("Plf. Memo."), p. 1.)

The court agrees with defendants that the amount of net assets to be distributed to the Class B debenture holders upon the sale or reorganization of GB&W is *the* core issue in this dispute. As alleged in paragraph 4 of the Second Amended Complaint (which is realleged in all counts), plaintiffs' claims are predicated on the alleged scheme by defendants "to destroy the value of the Class B debentures such that their value never exceeded their face value," and in their memorandum in opposition to defendants' motion for summary judgment plaintiffs state that "all schemes were put into place for purpose of stealing from the plaintiffs their rights to their share of the net proceeds and providing those net proceeds to Itel." (Plf. Memo., p. 11.)

Thus, even plaintiffs admit that the core issue to be decided by this court is whether plaintiffs have any rights to a share of the net proceeds. If not, then plaintiffs have no right to complain of defendants' conduct, cannot state a claim under any theory, and the complaint must be dismissed. If plaintiffs do have a right to the net proceeds, then the court must examine defendants' other arguments that the complaint fails to state a claim upon which relief may granted, violates Fed. R. Civ. P. 8(a)(2), and fails to plead fraud with particularity as required by Fed. R. Civ. P. 9(b).

Despite all of the previous litigation and the vast amount of paper filed by the parties, the issue before this court is a relatively simple matter of contract interpretation. The court must interpret the meaning of the asset/distribution provision contained in the Class B debenture in accordance with well-established rules of contract construction.

The general rule of contract interpretation is to determine the intent of the parties from the instrument as a whole, and not necessarily from isolated or particular parts thereof. *Carey v. Rathman*, 55 Wis. 2d 732, 200 N.W. 2d 591, 594 (1972).[2] The meaning of particular parts or words in a contract should be determined in light of and consistent with the general purpose of the agreement. *Id.* Since language in written instruments derives its meaning from its use in reference to other language and the general purpose sought to be expressed, the specific phrases and words must be considered in relation to the nature and the object of the transaction, and read in light of other provisions of the contract and of the circumstances surrounding its execution. *Id.*

The specific provision in question provides as follows:

> The Green Bay & Western Railroad Company hereby certifies that this is one of a series of 7,000 of its Class B Debentures, in the sum of ONE THOUSAND DOLLARS each, aggregating in all the sum of Seven Million Dollars, which sum of One Thousand Dollars will be payable to the bearer hereof as follows: viz., only in the event of a sale or reorganization of the Railroad and property of said Company, and then only out of net proceeds of such sale or reorganization which may remain after payment of any liens and charges upon such Railroad or property, and after payment of Six Hundred Thousand Dollars to the holders of a series of Debentures known as Class A, issued or to be issued, by said Company, in the sum of Two Million Five Hundred Thousand Dollars to and among the stockholders of said Company. Any such net proceeds remaining after such payments shall be distributed pro rata to and among the holders of this series of Class B debentures.

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[2] The parties agree that Wisconsin substantive law applies in this action.

This language is plain and unambiguous, and in this court's view can logically be interpreted in only one manner. Each debenture is one of a series of 7,000, each of which is in the sum of $1,000. That sum of $1,000 is payable to the bearer only in the event of the sale or reorganization of GB&W. The sum of $1,000 is payable only out of the net proceeds of any such sale or reorganization, and only if any proceeds remain after payment of all liens and charges, and after payment to the Class A debenture holders and common stockholders. If there are enough proceeds remaining, each Class B debenture holder will then receive the sum of $1,000 per debenture. If there is not enough money left after payment to the Class A debenture holders and the common stockholders to pay the $1,000 face value per outstanding debenture, then any such net proceeds as are remaining will be distributed to the Class B debenture holders on a pro rata basis. It is clear to this court that the parties intended that the Class B debenture holders were to receive $1,000 per debenture if there was enough money available to pay all of them that sum. If there was not enough money available to pay $1,000 per each debenture, then whatever money was available would be distributed on a pro rata basis.

Plaintiffs seek to compel a different result by relying on the last sentence, which states, "Any such net proceeds remaining after such payment shall be distributed pro rata to and among the holders of the series of Class B debentures." Viewed singularly and out of context, one could conclude that this line was intended to mean that the Class B debenture holders would receive all net proceeds remaining, even in excess of the face value of the debentures, making the Class B debenture holders owners of the equity of the company, as plaintiffs assert.

Such an interpretation would, however, require the court to ignore the statement in the first sentence of the debenture providing, "which sum of $1,000 will be pay-

able to the bearer hereof as follows." It is a basic axiom of contract construction that a contract must be construed to give meaning to each of its provisions, *American Motorists Insurance Co. v. Trane Co.*, 544 F. Supp. 669, 678 (W.D. Wisc. 1982), and that an interpretation that gives reasonable meaning to all provisions is preferable to one that leaves part of the language useless or inexplicable or creates surplusage. *Heritage Mut. Ins. Co., v. Truck Ins. Exchange*, 184 Wis.2d 247, 516 N.W.2d 8 (1994). Plaintiffs' interpretation would render the initial passage of the debenture (as well as most of the language quoted above) meaningless, and cannot be accepted.

Plaintiffs further assert that the wording of the Class B debentures cannot be read alone, but must be read in conjunction with the Class A debentures, the Articles of Incorporation and the Reorganization Agreement, because they were all drafted as part of a single transaction. The Reorganization Agreement provides in part:

> The said certificates of stock and debentures are to provide that no mortgage shall at any time be placed upon the said railroad or property, nor shall the same be leased or sold, without the consent of the holders of seventy-five percent in par value of the new Company at any time out-standing and in case of any future sale or reorganization shall, after payment of all liens and charges upon said property, be first distributed to and among the holders of Class A debentures and the stockholders pro rata, and any surplus remaining after payment of the face value of said Class A debentures and the par of said stock, shall be distributed pro rata to and among the holders of the Class B debentures.

The Articles of Incorporation contain language substantially similar to that found in the Class B debentures. Likewise, the Class A debentures contain language that indicates that the Class B debentures are payable only out of the proceeds from a sale or reorganization, and

that only after payment of all liens and charges, the entire face value of the Class A debentures and entire par value of capital stock, then any surplus is to be distributed among the holders of the Class B debentures.

Plaintiffs argue that when read together, these documents can lead only to the conclusion that the Class B debenture holders are to receive all of the surplus proceeds from the sale of GB&W to Wisconsin Central. Plaintiffs argue that this conclusion is consistent with, and indeed compelled by *GB&W v. C.I.R.*

The court disagrees. First, as already noted, *GB&W v. C.I.R.* held only that annual payments to the debenture holders were to be treated as dividends for income tax purposes. The court never held that the Class B debenture holders were on equal footing with the capital stockholders.

Even read together, all that the documents indicate is that the Class B debentures are subordinate to both the Class A debentures and the capital stock for purposes of distribution upon a sale or reorganization. The documents merely set out a payment scheme that provides that the Class B debenture holders are paid last, after all liens, charges, and the required payments to Class A debenture holders and the capital stockholders. Nothing in any of the documents indicates to this court that the Class B debenture holders are to receive anything other than face value, as clearly stated in the debenture itself.

Moreover, if this court is to look beyond the four corners of the Class B defentures (as plaintiffs contend), the court cannot read the documents in a vacuum, but rather must interpret them in light of the circumstances surrounding their creation. *See,* e.g., *Heritage Mutual,* 184 Wis.2d 247 (1994). As held by the *Eliasen I* court, GB&W was not designed to pursue the interests of the Class B debenture holders, whatever their interest in the equity. The history of the GB&W reorganization indicates

that the GB&W structure of priority and control was adapted entirely to protect the investment of the holders of the capital stock and Class A debentures. Despite plaintiffs' argument that valuable consideration was exchanged for the debentures, it is beyond dispute that the Class B debentures were offered to give some hope of eventual recovery to the stockholders and second mortgage bondholders of the Green Bay, Winona & St. Paul Railroad, who would have recovered nothing had that railroad been foreclosed.

Viewed in light of these circumstances, it is unreasonable to interpret the document to mean, as plaintiffs suggest, that if GB&W were ultimately to prosper, the Class B debenture holders, whose interests were subordinate to all others and who had given up virtually worthless securities for their debentures, would be the ultimate beneficiaries of that prosperity. It is far more reasonable and logical to interpret the document as it is plainly written: if the railroad prospered and was ultimately sold or reorganized, if there were sufficient funds after all other priority payments were made, the Class B debenture holders would receive the sum of $1,000. If there were not sufficient funds for each Class B debenture holder to receive $1,000 per debenture, then whatever funds were remaining would be distributed on a pro rata basis. Accordingly, the court concludes that the document is clear and unambiguous and under its plain wording, plaintiffs are not entitled to anything more than $1,000 per debenture upon the sale of GB&W to Wisconsin Central.

Because all of the plaintiffs' claims are predicated upon their incorrect assertion that they, as Class B debenture holders, are the real holders of the equity of GB&W, the complaint as a whole fails to state a claim upon which relief can be granted and must be dismissed.

## CONCLUSION

*For the reasons set forth above, defendants' motion to* dismiss is granted.

ENTER: April 24, 1995

/s/ Robert W. Gettleman
ROBERT W. GETTLEMAN
United States District Judge

## APPENDIX D

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS

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Case Number: 1:94-cv-04601

ELIASEN

v.

ITEL CORP.

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Assigned Judge: HONORABLE ROBERT W. GETTLEMAN

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MINUTE ORDER of 9/15/95 by Hon. Robert W. Gettleman: Having reviewed plaintiff's amended motion to alter or amend judgment pursuant to Rule 59(e) [89-1] and the memorandum filed in support and opposition to that motion, the motion is denied. Mailed notice

This docket entry was made by the Clerk on September 18, 1995

## APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago, Illinois 60604

May 30, 1996

Before HON. RICHARD A. POSNER, Chief Judge
HON. MICHAEL S. KANNE, Circuit Judge
HON. TERENCE T. EVANS, Circuit Judge

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No. 95-3458

AXEL N. ELIASEN, ROBERT V. ROLLHEISER,
and ALLAN L. APTER, on behalf of themselves
and all others similarly situated,
*Plaintiffs-Appellants,*

v.

ITEL CORPORATION, *et al.*,
*Defendants-Appellees.*

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Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division
No. 94 C 4601—ROBERT W. GETTLEMAN, *Judge*

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### ORDER

On May 13, 1996, plaintiffs-appellants filed a petition for rehearing with suggestion for rehearing en banc. All the judges on the original panel have voted to deny the petition, and none of the active judges has requested a vote on the suggestion for rehearing en banc. The petition is therefore DENIED.

## APPENDIX F

## UNITED STATES CODE ANNOTATED

### FEDERAL RULES OF CIVIL PROCEDURE FOR THE UNITED STATES DISTRICT COURTS

Amendments received to January 5, 1996

*For analysis of the Federal Rules of Civil Provedure, see analysis preceding Rule 1.*

### III. PLEADINGS AND MOTIONS

Rule 12. Defenses and Objections—When and How Presented—By Pleading or Motion—Motion for Judgment on Pleadings

(a) When Presented.

(1) Unless a different time is prescribed in a statute of the United States, a defendant shall serve an answer

(A) within 20 days after being served with the summons and complaint, or

(B) if service of the summons has been timely waived on request under Rule 4(d), within 60 days after the date when the request for waiver was sent, or within 90 days after that date if the defendant was addressed outside any judicial district of the United States.

(2) A party served with a pleading stating a cross-claim against that party shall serve an answer thereto within 20 days after being served. The plaintiff shall serve a reply to a counterclaim in the answer within 20 days after service of the answer, or, if a reply is ordered by the court, within 20 days after service of the order, unless the order otherwise directs.

(3) The United States or an officer or agency thereof shall serve an answer to the complaint or to a cross-claim, or a reply to a counterclaim, within 60 days after the service upon the United States attorney of the pleading in which the claim is asserted.

(4) Unless a different time is fixed by court order, the service of a motion permitted under this rule alters these periods of time as follows:

(A) if the court denies the motion or postpones its disposition until the trial on the merits, the responsive pleading shall be served within 10 days after notice of the court's action; or

(B) if the court grants a motion for a more definite statement, the responsive pleading shall be served within 10 days after the service of the more definite statement.

(b) How Presented. Every defense, in law or fact, to a claim for relief in any pleading, whether a claim, counterclaim, cross-claim, or third-party claim, shall be asserted in the responsive pleading thereto if one is required, except that the following defenses may at the option of the pleader be made by motion: (1) lack of jurisdiction over the subject matter, (2) lack of jurisdiction over the person, (3) improper venue, (4) insufficiency of process, (5) insufficiency of service of process, (6) failure to state a claim upon which relief can be granted, (7) failure to join a party under Rule 19. A motion making any of these defenses shall be made before pleading if a further pleading is permitted. No defense or objection is waived by being joined with one or more other defenses or objections in a responsive pleading or motion. If a pleading sets forth a claim for relief to which the adverse party is not required to serve a responsive pleading, the adverse party may assert at the trial any defense in law or fact to that claim for relief.

If, on a motion asserting the defense numbered (6) to dismiss for failure of the pleading to state a claim upon which relief can be granted, matters outside the pleading are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56.

(c) Motion for Judgment on the Pleadings. After the pleadings are closed but within such time as not to delay the trial, any party may move for judgment on the pleadings. If, on a motion for judgment on the pleadings, matters outside the pleadings are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56.

(d) Preliminary Hearings. The defenses specifically enumerated (1)-(7) in subdivision (b) of this rule, whether made in a pleading or by motion, and the motion for judgment mentioned in subdivision (c) of this rule shall be heard and determined before trial on application of any party, unless the court orders that the hearing and determination thereof be deferred until the trial.

(e) Motion for More Definite Statement. If a pleading to which a responsive pleading is permitted is so vague or ambiguous that a party cannot reasonably be required to frame a responsive pleading, the party may move for a more definite statement before interposing a responsive pleading. The motion shall point out the defects complained of and the details desired. If the motion is granted and the order of the court is not obeyed within 10 days after notice of the order or within such other time as the court may fix, the court may strike the pleading to which the motion was directed or make such order as it deems just.

(f) Motion to Strike. Upon motion made by a party before responding to a pleading or, if no responsive pleading is permitted by these rules, upon motion made by a party within 20 days after the service of the pleading upon the party or upon the court's own initiative at any time, the court may order stricken from any pleading any insufficient defense or any redundant, immaterial, impertinent, or scandalous matter.

(g) Consolidation of Defenses in Motion. A party who makes a motion under this rule may join with it any other motions herein provided for and then available to the party. If a party makes a motion under this rule but omits therefrom any defense or objection then available to the party which this rules permits to be raised by motion, the party shall not thereafter make a motion based on the defense or objection so omitted, except a motion as provided in subdivision (h)(2) hereof on any of the grounds there stated.

(h) Waiver or Preservation of Certain Defenses.

(1) A defense of lack of jurisdiction over the person, improper venue, insufficiency of process, or insufficiency of service of process is waived (A) if omitted from a motion in the circumstances described in subdivision (g), or (B) if it is neither made by motion under this rule nor included in a responsive pleading or an amendment thereof permitted by Rule 15(a) to be made as a matter of course.

(2) A defense of failure to state a claim upon which relief can be granted, a defense of failure to join a party indispensable under Rule 19, and an objection of failure to state a legal defense to a claim may be made in any pleading permitted or ordered under Rule 7(a), or by motion for judgment on the pleadings, or at the trial on the merits.

(3) Whenever it appears by suggestion of the parties or otherwise that the court lacks jurisdiction of the subject matter, the court shall dismiss the action.

(As amended Dec. 27, 1946, eff. Mar. 19, 1948; Jan. 21, 1963, eff. July 1, 1963; Feb. 28, 1966, eff. July 1, 1966; Mar. 2, 1987, cff. Aug. 1, 1987.)

## APPENDIX G

Rule 56. Summary Judgment

(a) For Claimant. A party seeking to recover upon a claim, counterclaim, or cross-claim or to obtain a declaratory judgment may, at any time after the expiration of 20 days from the commencement of the action or after service of a motion for summary judgment by the adverse party, move with or without supporitng affidavits for a summary judgment in the party's favor upon all or any part thereof.

(b) For Defending Party. A party against whom a claim, counterclaim, or cross-claim is asserted or a declaratory judgment is sought may, at any time, move with or without supporting affidavits for a summary judgment in the party's favor as to all or any part thereof.

(c) Motion and Proceedings Thereon. The motion shall be served at least 10 days before the time fixed for the hearing. The adverse party prior to the day of hearing may serve opposing affidavits. The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages.

(d) Case Not Fully Adjudicated on Motion. If on motion under this rule judgment is not rendered upon the whole case or for all the relief asked and a trial is necessary, the court at the hearing of the motion, by examining the pleadings and the evidence before it and by interrogating counsel, shall if practicable ascertain what material facts exist without substantial controversy and what material facts are actually and in good faith con-

troverted. It shall thereupon make an order specifying the facts that appear without substantial controversy, including the extent to which the amount of damages or other relief is not in controversy, and directing such further proceedings in the action as are just. Upon the trial of the action the facts so specified shall be deemed established, and the trial shall be conducted accordingly.

(e) Form of Affidavits; Further Testimony; Defense Required. Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith. The court may permit affidavits to be supplemented or opposed by depositions, answers to interrogatories, or further affidavits. When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials of the adverse party's pleading, but the adverse party's response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If the adverse party does not so respond, summary judgment, if appropriate, shall be entered against the adverse party.

(f) When Affidavits are Unavailable. Should it appear from the affidavits of a party opposing the motion that the party cannot for reasons stated present by affidavit facts essential to justify the party's opposition, the court may refuse the application for judgment or may order a continuance to permit affidavits to be obtained or depositions to be taken or discovery to be had or may make such other order as is just.

(g) Affidavits Made in Bad Faith. Should it appear to the satisfaction of the court at any time that any of the affidavits presented pursuant to this rule are presented

in bad faith or solely for the purpose of delay, the court shall forthwith order the party employing them to pay to the other party the amount of the reasonable expenses which the filing of the affidavits caused the other party to incur, including reasonable attorney's fees, and any offending party or attorney may be adjudged guilty of contempt.

(As amended Dec. 27, 1946, eff. Mar. 19, 1948; Jan. 21, 1963, eff. July 1, 1963; Mar. 2, 1987, eff. Aug. 1, 1987.)

## APPENDIX H

Additional corporate powers. SECTION 1828. [*As amended by ch. 185, 1883.*] Every corporation formed under this chapter shall, in addition to the powers conferred on corporations in chapter eighty-five, have power:

1. To cause such examination and surveys for its proposed railroad to be made, as may be necessary to the selection of the most advantageous route; and for such purpose, by its officers or agents and servants, to enter upon the lands or waters of any person, but subject to responsibility for all damage which shall be done thereto.

2. To take and hold such voluntary grants of real estate and other property as may be made to it, to aid in the construction, maintenance and accommodation of its railroad; but the real estate received by voluntary grant shall be held and used for the purposes of such grant only.

3. To acquire under the provisions of this chapter, or by purchase, all such real estate and other property as may be necessary for the construction, maintenance and operation of its railroad, and the stations, depot grounds, and other accommodations reasonably necessary to accomplish the objects of its incorporation; to hold and use the same, to lease or otherwise dispose of any part or parcel thereof, or to sell the same when not required for railroad uses only, and no longer necessary to its use.

4. To lay out its road not exceeding one hundred feet in width, and to construct the same; and for the purposes of cuttings and embankments, and of obtaining gravel or other material, to take as much land as may be necessary for the proper construction, operation and security of the road, and to cut down any standing trees that may be in danger of falling on the road, making compensation therefor as provided in this chapter for lands taken for the use of the corporation.

5. Subject to the provisions of section eighteen hundred and thirty-six, to construct its railroad across, along

or upon any stream of water, watercourse, street, highway, plankroad, turnpike or canal, which its route shall intersect or touch; to carry any highway, street, turnpike or plankroad, which it shall touch, intersect or cross, over or under its track, as may be most expedient for the public good; to change the course and direction of any highway, street, turnpike or plankroad, when made necessary or desirable to secure more easy ascent or descent by reason of any embankment or cut made in the construction of the railroad, and take land necessary therefor; provided, such highway or road be not so changed from its original course more than six rods, nor its distance thereby lengthened more than five rods.

6. To cross, intersect, join and unite its railroad with any railroad heretofore or hereafter constructed, at any point on its route, and upon the grounds of such railroad corporation, with the necessary turnouts, sidings and switches, and other conveniences in furtherance of the objects of its connections. And every corporation whose railroad is or shall be hereafter intersected by any new railroad shall unite with the owners of such new railroad in forming such intersections and connections, and grant the facilities aforesaid; and if the two corporations cannot agree upon the amount of compensation to be made therefor, or the points and manner of such crossings and connections, the same shall be ascertained by commissioners, to be appointed by the court, as is provided in this chapter in respect to acquiring title to real estate. But no corporation which shall have obtained the right of way and constructed its road at the point of intersection before the application for the appointment of commissioners may be made, shall be required to alter the grade or change the location of its road, or be required to bear any part of the expense of making and maintaining such crossing, or of such proceeding.

7. To take and convey persons or property over their railroad by the power or force of steam or of animals, or by any mechanical power, and to receive compensation

therefor; and to do all the business incident to railroad corporations.

8. To erect and maintain all necessary and convenient buildings, stations, fixtures and machinery for the accommodation and use of their passengers, freights and business, subject to the statutes in relation thereto.

9. To regulate the time and manner in which passengers and property shall be transported, and the compensation to be paid therefor, but in so doing, an unjust preference, advantage or monoply shall not be given to any person, company or corporation doing business at more than one station on the line of its railroad.

10. To borrow, from time to time, such sums of money at such rates of interest, and upon such terms, as the corporation or board of directors shall agree upon and authorize as necessary or expedient, and to execute trust deeds or mortgages, or both, as occasion may require, on any railroads or parts thereof, constructed or in process of construction, for amounts borrowed or owing by the corporation, and therein to make provision, granting, transferring or mortgaging their railroad track, right of way, depot grounds, rights, privileges, franchises, immunities, exemptions, machine houses, rolling stock, furniture, tools, implements, appendages, and appurtenances, used in connection with such railroads in any manner whatever, then belonging to the corporation, or which may thereafter belong to it, as security for any bonds or evidences of debt therein mentioned, in such manner as the corporation or directors shall think proper; and such instruments shall fully convey the same, or so much thereof as shall be therein described. In case of sale by virtue of any such trust deed, or upon foreclosure of any such mortgage, the persons acquiring title under such sale, and their associates, successors and assigns, or such corporation as they shall organize, according to section eighteen hundred and twenty, with all the powers conferred upon re-organized corporations by section seventeen

hundred and eighty-eight, shall thereafter have, exercise and enjoy all such described grants, which were purchased at such sale, including all rights, privileges, grants, franchises, immunities and advantages mentioned in such instruments, which were possessed by such corporation making the same, or contracting such debts, so far as the same relate or appertain to that portion or line of road granted or mortgaged and purchased at such sale, and no further, as fully and absolutely in all respects as such corporation, its shareholders, officers and agents might have done if such sale had not taken place. And whenever the person so acquiring title under any such sale shall own or represent a majority in amount of the bonds or other evidences of debt secured by any such trust deed or mortgage, and shall also include the persons who owned at the time of the sale a majority in amount of the capital stock of such mortgagor corporation, such purchasers, and such corporation as they shall organize as aforesaid, shall also have, possess and enjoy any special exemption, privilege or immunity previously granted by any law to such former corporation relating to any of the property so acquired, to the same extent as if such latter corporation had been named in such law as the grantee thereof.